

# **NAVAL POSTGRADUATE SCHOOL MONTEREY, CALIFORNIA**



## **THESIS**

**ANALYSIS OF THE U.S. FOREIGN MILITARY  
SALES (FMS) PRICING, BILLING, CONTRACT  
CLOSURE, AND FMS CONTRACT ADMINIS-  
TRATION BY THE TURKISH NAVY (TN)**

by

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September 1995

Principal Advisor:

Mark W. Stone

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**ANALYSIS OF THE U.S. FOREIGN MILITARY SALES (FMS)  
PRICING, BILLING, CONTRACT CLOSURE, AND FMS CONTRACT  
ADMINISTRATION BY THE TURKISH NAVY (TN)**

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Submitted in partial fulfillment  
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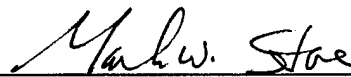
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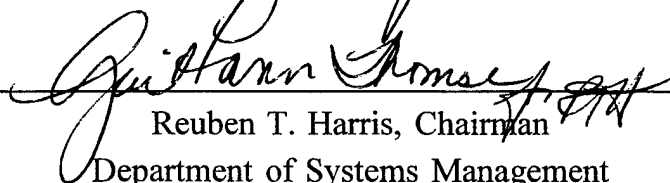
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## **ABSTRACT**

Turkey embarked upon an intensive program to modernize its armed forces to bring them in line with emerging technologies and the requirement of NATO. Foreign Military Sales (FMS) has been, and is still, one of the most important Security Assistance Programs that Turkey uses to modernize and maintain its armed forces.

The purpose of this thesis is to document and analyze issues involved with FMS pricing, billing, contract closure, and FMS contract administration by the Turkish Navy.

Adopting the recommendations in this thesis should improve the administration of FMS contracts by the Turkish Navy. Additionally, this thesis contributes to the knowledge needed by the Turkish field officers who will work in implementing FMS contracts.



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## I. INTRODUCTION AND BACKGROUND

### A. INTRODUCTION

#### 1. General

Arms transfers among all countries of the world have reached new levels since the end of World War II, particularly in the last decade. Arms sales have become big business and, consequently, a crucial dimension of international affairs. Today, more countries, both developed and developing, have greater destructive capabilities than ever before. Sophisticated arms, particularly in developing countries, represent one of the most prominent and disquieting features of our era.

Arms sales are said to be an indirect means of ensuring a nation's defense, making it possible for recipient nations to defend their security. They also are instruments of diplomacy, used either to develop closer relations between trading countries or to avoid their deterioration. Some believe arms sales buy influence and unseen leverage, which is accumulated for use at critical times when the supplier nation needs support from foreign nations. [Ref. 1:p. 1]

Continuing scientific and technological innovations in our era make it possible to produce more numerous, more accurate and more destructive weapon systems each year. However, especially in developing countries, it is extremely difficult to produce a variety of advanced arms, based on high technology. Often these countries do not have sufficient internal economic resources to establish an advanced domestic arms industry. They still require technologically advanced weapon systems, however, for self defense. Although there are numerous agreements to decrease nuclear arms stockpiles among the superpowers, conventional arms transfers continue to increase each year. Thus, less technologically advanced countries will continue to purchase military weaponry from international sources.

Since the end of World War II, the United States has grown into one of the major arms suppliers for its allies and friendly countries. First, the U.S. provided arms on a "grant aid" basis. Later, when the recipient country made significant economic progress, "sales" replaced grant aid. Today, the transfer of military weaponry from the United States to other countries is done in three basic ways: grants, loans or sales (Military or Commercial).

To implement such world-wide transfers via the Sales Program, the United States developed the concept of "Security Assistance." This covers a broad range of programs which employ funding and the legal authority to provide defense articles and training, economic support, and peacekeeping assistance to key friends and allies. In order to monitor these programs, the United States has established subcommittees within Congress and organizations within the Departments of Defense and State. [Ref. 1:p. 1-3]

U.S. security assistance programs assisted Turkey with modernizing its armed forces. A decade ago, Turkey embarked upon an intensive program to modernize its armed forces to bring them in line with emerging technologies and NATO requirements. The political and military leadership of Turkey has made it abundantly clear that they place a high priority on ensuring that the Turkish Armed Forces remain completely capable and fully prepared to carry out its national defense mission, its NATO missions, and any future requests by the United Nations in its many peace-keeping roles. Turkey acquired eight Knox Class Frigates in 1993-1994 and is currently working on a program to transfer Perry Class Frigates to the Turkish Navy to modernize it under the security assistance umbrella of the U.S.

From 1946 to 1992, Turkey received more than \$11 billion in the form of grants, credits, cash sales and other forms of military assistance from the U.S. [Ref. 2:p. 174]. For 1993, Turkey ranked third in a list of countries to accept aid from

the United States, receiving \$450 million [Ref. 6:p. 9]. Fiscal Year 1994 actual was \$426 million, the fiscal year 1995 estimate is \$393 million and fiscal year 1996 request by Turkey is \$503 million. [Ref. 7:p. 55]

## **2. Objectives of the Thesis**

This study identifies, and analyzes the issues concerning FMS contract administration, pricing and billing, and case closure with respect to Turkish Navy (TN) procurement. The research and analysis involved in this thesis will contribute to an understanding of the U.S. Foreign Military Sales (FMS) Process, pricing and billing, contract closure, and contract administration for the Turkish Navy. It allows field level Turkish officers to accomplish their tasks more efficiently and generate savings within the FMS process.

## **3. Research Questions**

### **a. Primary**

What are the significant issues involved with United States Foreign Military Sales contract administration, pricing and billing, and contract closure for the Turkish Navy and how can they be resolved?

### **b. Subsidiary**

1. What are the FMS procedures for procurement from the U.S. Government?
2. How is a contract (Letter of Offer and Acceptance) prepared for FMS?
3. What is the methodology employed in developing an FMS price?
4. What are the methods of funding FMS transactions?
5. What is the procedure for FMS billing, case reconciliation, and closure?
6. What is the contract administration process followed by TN?

## **4. Scope and Limitation of Research**

The scope of this thesis includes documentation and analysis of issues involved with the Foreign Military Sales

(FMS) contract administration, pricing and billing, and contract closure for the Turkish Navy since 1990.

The scope of this research is limited to an analysis of U.S. FMS procedures and documents that are used in the process which affect Turkish Navy procurement.

## **5. Methodology**

Research included a review of documents associated with the U.S. FMS policy, procedures, and reports related to TN procurement. Interviews were conducted with the Turkish Naval Supply Attache, Washington, D.C.; the FMS Liaison Officer, NAVILCO, Philadelphia, PA, and the FMS Project Officer, Turkish Naval Forces Command, Ankara, Turkey.

After all the information was gathered, FMS pricing, billing, case closure, the FMS contract administration by TN were analyzed along with problems specifically related to TN procurement.

## **6. Organization of Study**

Chapter I discusses the background and objectives of the thesis.

Chapter II explains the U.S. Foreign Military Sales Process and FMS Contractual Agreements.

Chapter III discusses U.S. FMS pricing and billing, contract closure, and contract administration for the Turkish Navy.

Chapter IV presents an analysis of issues involved with the FMS contract administration, pricing and billing and contract closure for the Turkish Navy.

Chapter V concludes the thesis and presents recommendations regarding the subject.

## **B. BACKGROUND**

### **1. History**

Arms transfers have been part of international relations as long as mankind has been involved in war. The basic desire to obtain arms has not changed, only the mechanisms of

transfer have changed depending on policy, the technology involved and the military and political relations between trading countries. Since World War II, terms of transfer changed from "aid" to "trade," the focus has shifted to Third World countries, arms have become more sophisticated, and more countries are able to procure these advanced arms. [Ref. 3:pp. 13-14]

Shortly after World War II, Soviet diplomatic pressure in Turkey and communist guerilla actions in Greece became a concern for President Truman in the United States. Truman felt the spread of Soviet hegemony was inimical to Asia Minor, the Dardanelles, Balkans and the Persian Gulf. In support of his doctrine, Truman proposed to Congress a military aid package for Turkey and Greece. In his address to Congress, President Truman stated:

I believe that it must be the policy of the United States to support free peoples who are resisting attempted subjugation by armed minorities or by outside pressure. I believe that we must assist free peoples to work out their own destinies in their own way. I believe that our help should be primarily through economic and financial aid which is essential to economic stability and orderly political processes. [Ref. 3:p. 14]

The passage of this legislation is recognized as the basis for what is known as the Foreign Military Assistance Program, later the main thrust behind the creation of the Foreign Military Sales Program.

In 1948, Secretary of State George Marshall proposed heavy American aid to help Europe recover from the demolished economy caused by World War II. Congress accepted the request and established the European Recovery Plan (ERP), or Marshall Plan, offering assistance to 16 nations in Western Europe. This plan, however, did not include Turkey. [Ref. 3:p. 15]

With the establishment of the North Atlantic Treaty Organization (NATO) in 1948, Security Assistance Programs

became more important. Because NATO was created to be a bulwark against communist expansion in Western Europe, its existence forced allies to increase assistance to member nations, including Turkey.

Security Assistance was enlarged during the Eisenhower years. President Eisenhower initiated a request regarding assistance to various Middle Eastern nations in resisting external armed aggression from a perceived communist threat. Congress approved the President's proposal by joint resolution on March 9, 1957. Eisenhower's belief was that the loss of the Middle East to "international communism" would constitute a severe and fatal blow to American interests. This policy continued through the mid-1960's, with allies receiving approximately 56 percent of all American arms via the Military Assistance Program or FMS Program. [Ref. 3:p. 16]

On October 22, 1968, Congress enacted the Foreign Military Sales Act, which consolidated into a single act all legislation to authorize sales of arms by the United States to allies and friendly foreign countries. In initiating this legislation, Congress declared that the ultimate goal of the United States was a world which was free from war and the dangers of arms expansion. Furthermore, United States policy encouraged regional arms control and discouraged arms races. This legislation also shifted emphasis from the Military Assistance Program to Foreign Military Sales.

The expansion of arms sales continued, and after the Vietnam War, the U.S. Congress believed that arms sales, unless controlled properly, would lead to further violence and regional wars. Congress, therefore, added additional guidelines and restraints to govern the management of FMS. In 1976, Congress attempted to expand its control over FMS Programs, but President Ford vetoed the legislation aimed at providing ceilings on all U.S. arms sales abroad. In the end, however, the level of FMS was effectively limited.

With passage of the 1976 legislation, the following changes emerged:

- The 1976 Legislation became known as the "International Security Assistance and Arms Export Control Act of 1976."
- Export licenses for all military sales over \$25 million would be required.
- An extension of congressional control over proposed FMS sales over \$7 million for major weapon systems and over \$25 million for any other defense articles or sources was added. If Congress does not disapprove a proposed sale within 30 days, the sale is in effect approved.
- Department of Defense (DoD) would have Military Assistance Advisory Groups in various countries around the world to provide advice and assistance to local governments in the purchasing and operation of American arms.

President Carter later became concerned when arms sales had risen to over \$20 billion and the U.S. accounted for over half of those sales. Based on this fact, he directed a review of the existing arms control policy and all the associated military, political and economic factors. [Ref.3:pp. 21-22]

Carter initiated an additional set of arms controls:

- A reduction of the dollar volume of FMS and Military Assistance Program. At the end of Fiscal Year 1977, the U.S. had a backlog of undelivered FMS weapon systems of almost \$36 billion, and a year later it was \$44 billion.
- The U.S. will not be the first country to introduce newly-developed advanced weapons into a region.
- Development and significant modification of advanced weapon systems will not be permitted for foreign countries.
- Weapon systems cannot be retransferred by the purchasing nation to a third world country under any circumstances.

- U.S. Embassies and Military Representatives abroad will not be allowed to promote arms sales. Department of State policy-level approval was also added.

NATO Countries, Australia and New Zealand would be exempt from the above restraints. As a general assessment, Carter's policy of restraint was a failure and was never fully implemented. It did establish functional Government procedures for handling arms transfer requests and decreased requests for arms, but controls were not implemented in a systematic way.

President Reagan established a new arms transfer policy which viewed arms transfer as an essential element of U.S. global defense policy and an indispensable component of U.S. foreign policy. The policy is summarized below. [Ref. 3:pp. 23-24]

- Reinforce military capabilities to assist in the deterrence of aggression, especially from the USSR and its surrogates, and reduce the requirement for direct U.S. involvement in regional conflict;
- Reinforce the perception of friends and allies that the U.S., as a partner, is also a reliable supplier in the security of the recipient country;
- Point out to potential enemies that the U.S. will not abandon its allies or friends or allow them to be militarily disadvantaged;
- Improve the American economy by assuring a more stable defense production base, and by enhancing the balance of payments;
- Enhance the effectiveness of the U.S. military;
- Strengthen the stability of a region and the internal security of the countries within that region.

The policy changes under President Reagan have not led to significantly higher arms export levels, even though ceilings on arms sales were dropped. Moreover, he opened up new

dialogues with Central American and South American countries. Foreign assistance and sales to Europe focused on Turkey, Greece, and Portugal in support of NATO and a U.S. defense agreement with Spain for use of Spanish bases. Turkey also received sizeable financial support in recognition of its continuing economic needs. Korea, the Philippines, Indonesia and Thailand have been scheduled for FMS financing for modernization programs.

President Reagan's policy assumed that arms transfers could help deter aggression from neighboring countries. Under this policy, each request for arms was reviewed on a case-by-case basis, primarily in terms of its contribution to deterrence and defense. [Ref. 3:p. 25]

Arms transfer and overall security assistance policies of the Bush Administration essentially represented a continuation of the approach which evolved during the Reagan Presidency. However, various key events occurred in the world, each of which had a significant impact on U.S. foreign policy and security assistance. These events included: the December 1989 collapse of the Iron Curtain and the subsequent emergence of democracy in most former Warsaw Pact countries; the August 1990 Iraqi invasion of Kuwait and the subsequent January/February 1991 Operation Desert Storm; Middle East peace talks; the December 1991 economic and political dismemberment of the USSR; and finally, the far reaching worldwide economic recession of 1991 and 1992.

Despite these significant world problems, the Clinton Administration's initial emphasis was on rebuilding the U.S. economy and on establishing a predominantly domestic agenda. In terms of the administration's foreign policy and national security interests, initially there was little departure from the previously stated goals of building democracy, promoting and maintaining peace, promoting economic growth and sustainable development, addressing global problems, and meeting urgent humanitarian needs.

With the end of the Cold War and the disintegration of the Soviet Union came the desire to attain peace dividends in the form of reduced defense budgets and the rapid downsizing of the U.S. military force structure. The savings gained would help to fund certain domestic programs, such as reducing the budget deficit and funding a health care reform package.

As has been the trend in past years, the amount of money funded for the major security assistance programs declined during the Clinton administration. Congress significantly reduced the Foreign Military Financing Program (FMFP), and encouraged embassies to actively assist U.S. marketing efforts overseas. The positive impact of FMS case sales on the U.S. economy was seen in Fiscal Year 1993 and was due primarily to major defense equipment sales to countries in the Arabian Gulf, where signed cases topped \$33 billion. [Ref. 3:pp. 26-29]

## **2. U.S. Security Assistance Program Components**

U.S. Security Assistance Programs are comprised of seven major components [Ref. 3:pp. 41-45]:

- Foreign Military Sales (FMS) and Foreign Military Construction Program - eligible governments purchase defense articles, services and training from the U.S. Government.
- Foreign Military Sales Financing Program - credits and loan repayment guarantees are provided for the direct procurement of arms.
- Commercial Sales - sales by U.S. firms directly to foreign buyers.
- International Military Education and Training Program (IMET) - military education and training aid given in the United States or at overseas facilities on a grant aid basis.
- Economic Support Fund - provides loans for economic support and technical assistance development projects.

- Peacekeeping - operations providing funds for international security forces such as the United Nations.
- Nonproliferation and Disarmament Fund - provides funds for the nonproliferation of weapons of mass destruction. Aimed at assisting the republics of the former Soviet Union in the dismantling and destruction of their nuclear weapons.

### **C. SUMMARY**

U.S. Security Assistance covers a broad range of programs which employ funding and the legal authority to provide defense articles and training, economic support, and peacekeeping assistance to key friends and allies. One of those programs, FMS, has been, and is still, one of the most important security assistance programs used by Turkey to modernize and maintain its armed forces.

FMS is discussed in the following chapters, starting with the FMS process and contractual agreements in Chapter II.



## **II. THE FOREIGN MILITARY SALES (FMS) PROCESS AND CONTRACTUAL AGREEMENTS**

### **A. THE FMS PROCESS**

The U.S. Security Assistance Program serves as a fundamental instrument for achieving U.S. foreign policy objectives. Before a transfer of any U.S. defense articles or services can be made to any foreign country or international organization, the President must formally find that such assistance will strengthen U.S. security and promote world peace. [Ref. 4:Sec. 3]

In order that U.S. security assistance plans may complement a country's own military plans and budgets, there should be ongoing consultations during the planning process between U.S. and host country representatives. Such discussions are conducted primarily between Security Assistance Office (SAO) personnel and Ministry of Defense officials in the host country. These discussions, covering material acquisition programs, training plans, and related security assistance matters, generally provide the basic input phase of the FMS sales process. [Ref. 3:p. 147]

#### **1. Letter of Request (LOR)**

Based on the nature of a country's request, the process for negotiating and implementing an FMS case can vary widely. There are, however, some general guidelines to be followed.

The first step is to determine the U.S. approved channels of submission for the Letter of Request (LOR). A LOR is a request from an eligible FMS participant country for the purchase of U.S. defense articles and services. The channels used are based upon whether the request is for "Significant Military Equipment (SME)" or for "All other FMS (non-SME)" requirements. SME are items designated in the International Traffic in Arms Regulation that warrant special export controls because of their capacity for substantial military utility. Requests for Major Defense Equipment (any item of

significant military equipment having a nonrecurring research and development cost of more than \$50 million or a total production cost of more than \$200 million) are treated as requests for SME. Figure 1 diagrams the channels of submission for an LOR. [Ref. 3: p. 149]

**a. Requests for SME**

Requests to purchase SME which originate in-country should be transmitted by the U.S. Embassy rather than by the SAO or similar military element of the Embassy. These requests must be addressed to the cognizant DoD component, with information copies to the Bureau of Political Military Affairs, Department of State (SECSTATE/PM), the Office of the Secretary of Defense, Defense Security Assistance Agency (SECDEF/DSAA), and the unified command. Requests to purchase SME which originate with purchasing country representatives in the United States should also be addressed to the cognizant Department of Defense (DoD) component with information copies to SECSTATE/PM and to DSAA. [Ref. 3:p. 147] The U.S. Embassy provides an assessment of the proposed sale to include a statement of the reason the nation desires the weapon systems and the anticipated reaction of neighboring nations.

**b. All Other FMS (non-SME)**

Requests originating in the purchasing country should be transmitted either by the customer country's authorized representative or the DoD element of the U.S. country team directly to the cognizant DoD component. Requests originated by foreign representatives of the customer country in the U.S. should be sent directly to the cognizant DoD component. [Ref. 3:pp. 147-148]

Before any further action is taken on the LOR, it must be validated to insure the potential customer is an eligible FMS recipient, that the article or service sought may be sold.

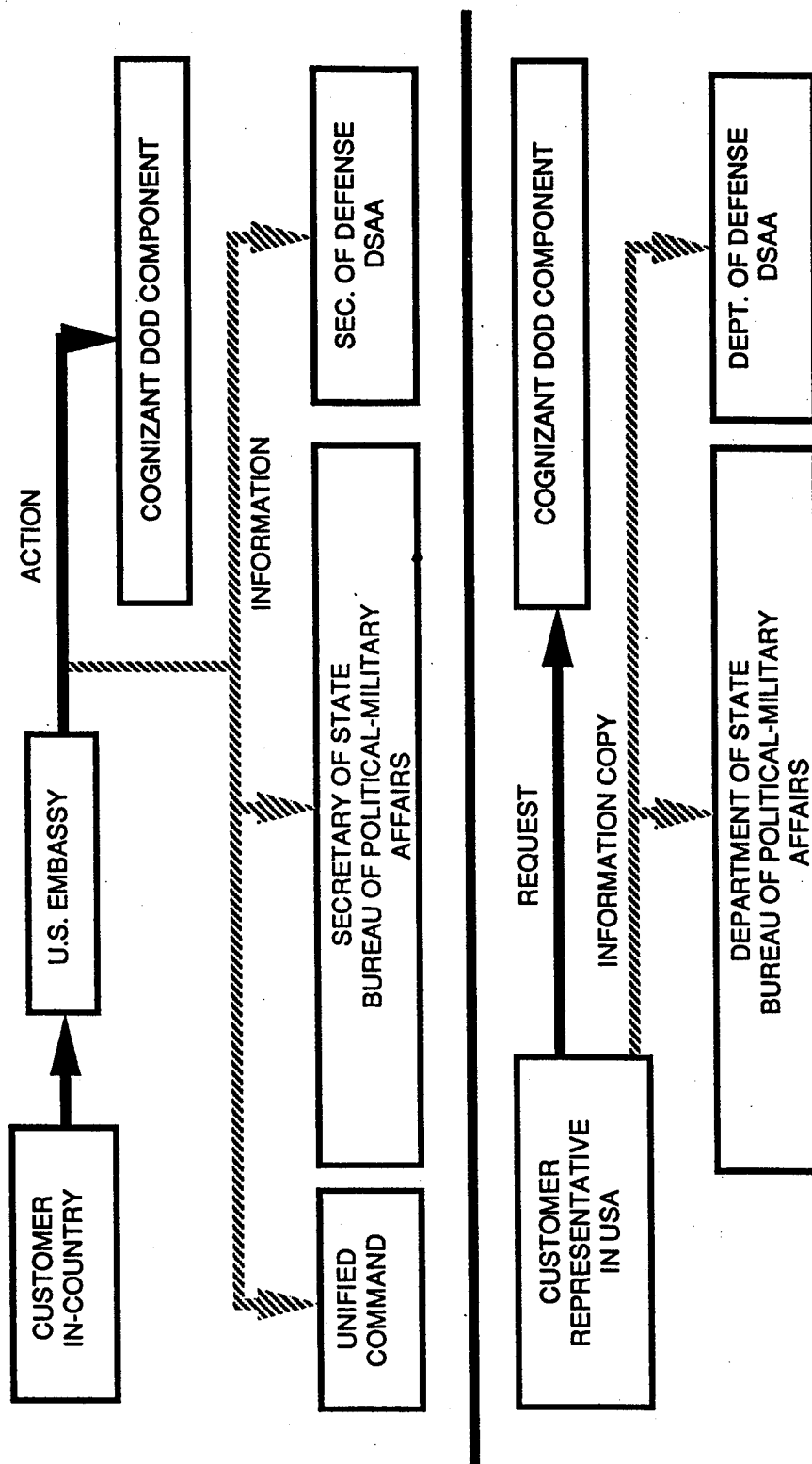


Figure 1. Channels of Request, SME [Ref. 3:p. 149]

DSAA maintains a Military Articles and Services List (MASL), which is distributed to agencies who prepare LOAs. It provides a generic listing of the military articles and services offered under an FMS case. If a requested item does not appear in the MASL, then a policy-level decision must be made before the item may be added to the MASL and offered for sale. [Ref. 3:p. 153]

Formal acknowledgment to the customer of receipt of a valid LOR is required within five days of such receipt by the military department (MILDEP).

An LOR may be submitted directly to State or DSAA if it is deemed to be of such a sensitive nature that higher level review is required. Based upon receipt of the information copies of the LOR, State and DSAA will, within five working days, initiate the necessary coordination to determine if there will be any objection to the proposed sale.

While there is no standard format for a LOR, there is some common content that should be included. The LOR should state clearly if it is a request for Price and Availability (P&A) data, or a request for a Letter of Offer and Acceptance (LOA). [Ref. 3:p. 148]

## **2. Price and Availability (P&A) Data**

Price and Availability (P&A) estimates reflect rough order of magnitude data; they are provided for planning purposes only, and show estimated costs and projected availability of defense articles or services. P&A data will normally be provided within 45 days of receipt of an LOR. P&A estimates are not normally valid for the preparation of an LOA, and such preliminary data will not serve as a basis for constructing an LOA.

DoD components should ensure that P&A data are sufficiently accurate for planning purposes, although not necessarily for budgeting. When DSAA approval is provided (within five working days of receipt of the request, unless otherwise

advised), no further staffing with DSAA is required. [Ref. 3:p. 148]

### **3. The Letter of Offer and Acceptance (LOA)**

The Letter of Offer and Acceptance is the official document used by the U. S. Government (USG) as an offer to sell defense articles and services to a foreign country or international organization. The offer becomes a contract when it is accepted by a representative of the purchasing country or international organization. The LOA is subject to many conditions and restrictions referred to as "Standard Terms and Conditions." These terms and conditions are defined later in this chapter.

For LOAs received prior to 1 June 1992, the format for the LOA was a DD Form 1513, also referred to as an LOA. LOAs and DD Forms 1513 are also referred to as FMS "cases." To differentiate the approximately 18,000 open cases, each LOA is assigned a unique case identifier. [Ref. 3:p. 150]

Implementing Agencies (IA) are those USG agencies authorized to receive LORs. In accordance with DoD policy, the applicable IA should write the LOA within 60 days after receipt of the LOR and forward it to DSAA for countersignature. After countersignature, the IA then forwards the LOA to the purchaser for acceptance. The three kinds of LOAs or "cases" written by the IAs are described below.

#### **a. Defined Order**

A *defined order case* is one in which the defense articles, services, or training requirements are specified/quantified by the purchaser in the FMS customer's Letter of Request. These cases are often referred to as "Defined Line or Push Requisitioning" by the U.S. Navy. [Ref. 3:p. 187]

A defined order case normally requires a complete LOA data study of separately deliverable line items. This study can range from extensive efforts, including contacts with potential contractors, to determining the latest most

representative procurement price, applying an appropriate inflation factor.

The types of defense articles, services, or training normally processed as defined order cases are shown below:

- System/Package Sales--includes major items and weapon systems (e.g., tank, ship, airplane, missile, etc.) and any related requirements to activate and operate an item or system during an initial period of time.
- Munitions, Ammunition and other Explosives.
- Transportation Services.
- Aircraft Ferry.
- Cartridge Actuated Devices/Propellant Actuated Devices.
- Technical Data Packages.

**b. Blanket Order**

A *blanket order case* is an agreement between a purchaser and the United States Government for a specific category of items or services with no definitive listing of items or quantities. The LOA specifies a dollar ceiling against which orders may be placed. Customers may requisition against a blanket order case as long as funds are available. These cases are commonly called "Direct Requisitioning Procedures/Open End Requisitioning of Pull Requisitioning" by the U.S. Navy. [Ref. 3:p. 187]

The blanket order cases are normally used to process the following items:

- Spares and Repair Parts.
- Publications.
- Support Equipment.

- Minor Modifications/Alterations Performed at U.S. Military Installations.
- Technical Assistance Services.
- Training.
- Training Aid Devices.
- Repairables.

**c. Cooperative Logistics Supply Arrangement (CLSSA)**

CLSSA is a military logistics support arrangement designed to provide responsive follow-on supply support for United States-produced military hardware possessed by foreign countries. [Ref. 3:p. 189]

**4. Compilation of LOA Data**

The actual LOA data estimates are made by the applicable service program/system/item manager. They are based either on contractors' quotes, or on the current or projected cost and availability of the desired items. A key element in obtaining complete LOA data is the identification of each of the required items and services. The primary responsibility for this identification usually rests with the Navy Systems Commands for major system cases.

Generally, it is the responsibility of the FMS case manager within these agencies to obtain and review the necessary detailed data on costs, schedules, configuration, and other factors for preparing an FMS proposal. The proposal is coordinated with other activities. The scope of these activities, the time involved, and the level at which they take place depend on a number of factors--political, as well as technical and financial. Figure 2 reflects the Navy's organizational structure and processing flow for the compilation of LOA data for a major weapon systems sale. [Ref. 3:p. 156]

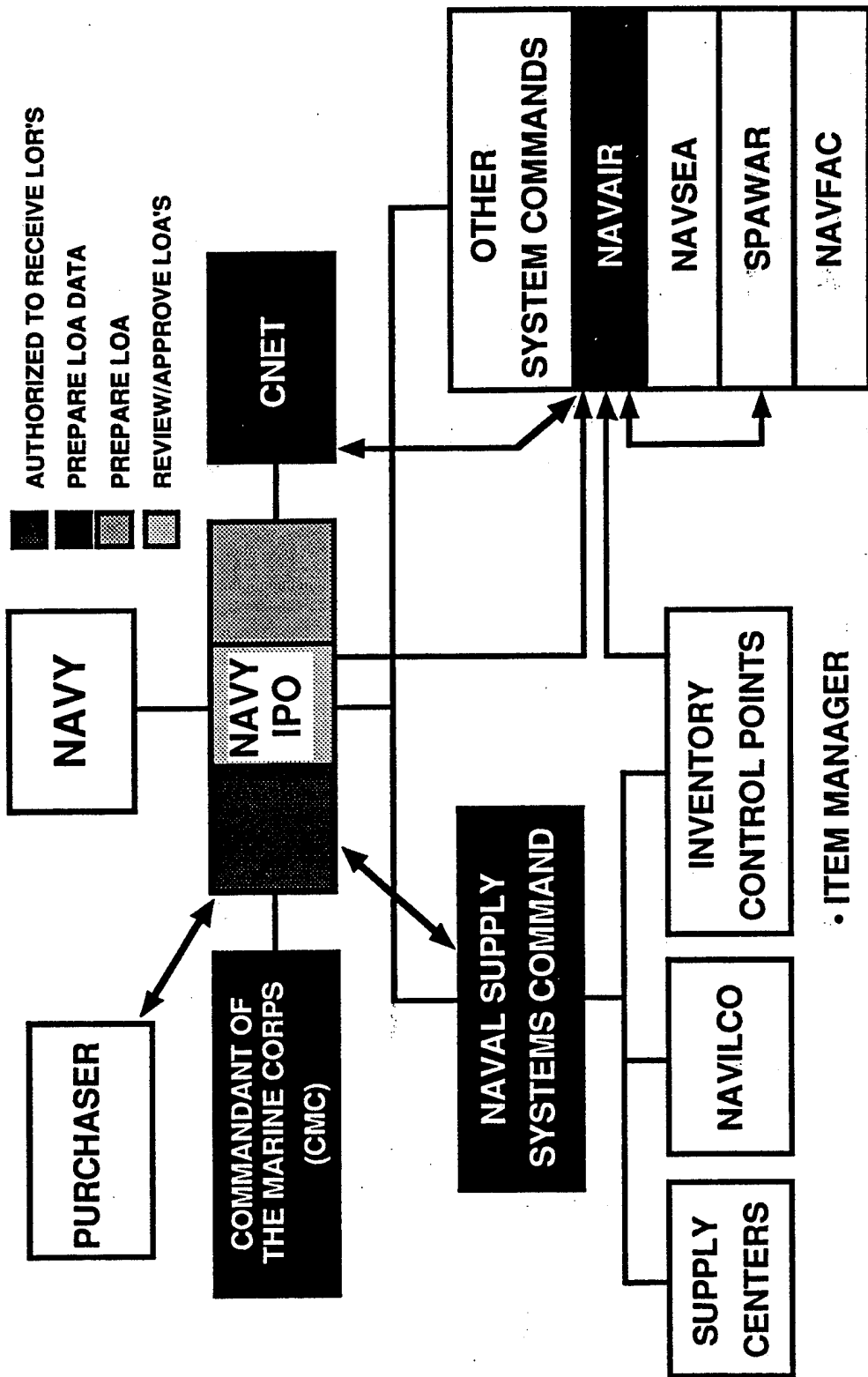


Figure 2. Navy Weapon System Sale [Ref. 3:p. 156]

The LOA is written by the officer designated by the implementing agency. Within the Navy they are written by the International Programs Office (Navy IPO).

## **5. Final Review of LOA**

### **a. DSAA Countersignature**

The DoD components should forward the LOA to the DSAA Comptroller for countersignature prior to release to the purchaser.

Those cases which must be presented to Congress also undergo this DSAA policy review process. The DSAA review for such cases begins within ten working days after the LOA preparation is begun, or as soon as it is anticipated that the offer will meet one of the congressional reporting thresholds. [Ref. 3:p. 160]

### **b. Department of State (DoS) Review**

The DoS is responsible for the approval of all proposed sales prior to the notification to Congress. The DoS authorizes DSAA to furnish Congress advance notification of each sale. The advance notification, which is not a statutory requirement, provides for a 20 calendar day preliminary congressional examination period. [Note: This advance notification is not required for offers to NATO, NATO members, Australia, Japan or New Zealand.] After 20 days, DSAA submits the formal 30-day (15-day in the case of an offer to NATO, NATO members, Australia, Japan or New Zealand) notification to the Congress as required by Section 36(b) of the Arms Export Control Act, as amended. The potential purchaser is normally provided a courtesy copy of the unsigned LOA as a matter of information. [Ref. 3:p. 161]

### **c. Other DSAA Coordination Actions**

DSAA completes any other necessary coordination for the proposed sale. As a final check, a list of proposed LOAs to be issued is compiled by DSAA for review by the Department of State Bureau of Political-Military Affairs. Following this action, if no objections are encountered, and if Congress does

not object to the proposed sale within 30 (or where applicable 15) calendar days, the DSAA Comptroller "countersigns" the LOA and forwards it to the cognizant DoD component for submission to the requesting government. At the same time, a copy is sent to the Defense Finance and Accounting Service--Denver Center, Directorate for Security Assistance (DFAS-DE/I). [Ref. 3:p. 161]

#### **6. Acceptance of Offer by Purchaser**

If the offer is acceptable, the purchaser is normally given 60 days to complete and sign the LOA, and forward copies to the military department and DEFAS-DE/I with any required initial payment on or before the expiration date listed on the offer. Within five days of acceptance or rejection, the SAO or signature authority for the LOA should advise DSAA, DEFAS-DE/I, and the IA of the status of the LOA. [Ref. 3:p. 161]

#### **7. Implementation of the Case**

After receiving the initial deposit, DFAS-DE/I releases the obligational authority (O/A) to the cognizant DoD component. The O/A is evidence that proper case acceptance, including cash deposit, has been received and the case may be implemented.

A typical program involves the procurement of items from new production, as well as the provision of selected items from government stocks. Items to be procured are contracted from industry by cognizant Government buying activities. FMS requirements may be consolidated with USG requirements or placed on a separate contract, whichever is more expedient and cost effective.

The actual procurement and supply actions for the FMS program are carried out by USG procurement and logistics activities using largely the same internal management organizations as for USG programs. The Implementing Agencies may establish separate offices or positions within their organizations to provide overall surveillance of the FMS program, and

they serve as an interface with other organizations involved in managing the program. [Ref. 3:p. 162]

Some FMS customers have chosen to establish small liaison offices within the USG program management offices and the contractors' facilities as well. Liaison offices are also located at inventory control points and International Logistics Control Offices (ILCOs). Each military department has a central supply and/or financial control organization generally called "ILCOs." This organization is the **Navy International Logistics Control Office** in Philadelphia PA, for the U.S. Navy. [Ref. 3:p. 164]

When all items and services listed in the LOA have been shipped or performed, an FMS case is considered supply complete or delivered and is then ready to undergo the FMS case closure process. Figure 3 is a sample timeline for the major events that may occur in the entire FMS process cycle. [Ref. 3:p. 165]

## **B. CONTRACTUAL AGREEMENTS**

### **1. Contract**

A contract is an agreement between two or more parties which is enforceable by law. Six elements must be present for an agreement to be enforceable as a contract. [Ref. 5:pp. 627-630]

#### **a. Offer**

The offer is nothing more than a proposal, conditioned either upon performance of an act by the offeree, or upon a return promise by the offeree to enter into a contract. In order for the offer to be valid: (1) the expression must be intended as an offer; (2) it must be definite and clear in its terms; and (3) it must be communicated (in the manner intended) to the offeree.

Using the LOA as a model for discussion, the formal offer is made by the preparation of the LOA, the signature of

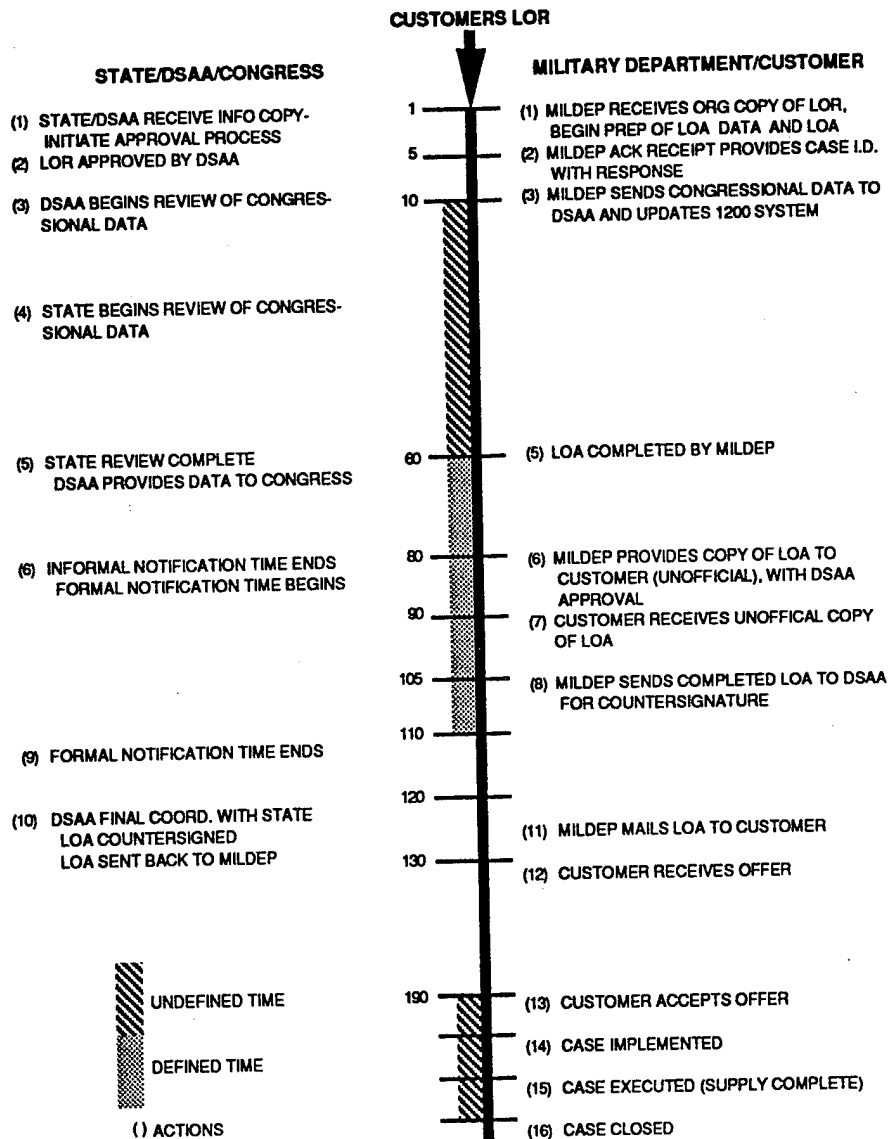


Figure 3. FMS Process (Days) [Ref. 3:p. 159]

the authorized U.S. Government representative in the document, and the presentation of the offer to the recipient country.

**b. Acceptance**

The acceptance is an expression of consent to the proposed contract. In order for the acceptance to be effective, it must be: (1) clear and unequivocal; (2) timely (i.e., it must occur before the offer is revoked); and (3) in the same terms as the offer.

Acceptance of the LOA is evidenced by completion of the Acceptance portion of the document. In addition to the LOA being properly signed (accepted) by the recipient country representative *prior to the expiration date* of the offer, the recipient country must accompany the LOA with the specified *initial deposit*. In effect, payment of the initial deposit is a condition of acceptance, and the Standard Terms and Conditions of the LOA make clear that implementation of the FMS case cannot proceed without a proper acceptance.

To avoid the problem of a "counter offer," the purchasing country should not make "pen-and-ink" changes to the LOA or Amendment. Rather, "pen-and-ink" changes constitute modifications to an LOA or Amendment and should be made only by the issuing DoD component prior to acceptance by the purchaser. [Ref. 3:p. 212]

**c. Competent Parties**

In the simplest sense, this means that both parties must have legal capability to enter into the contract. While legal capacity usually is not an issue in FMS cases, the proper execution of contract documents by authorized representatives of the respective governments is a potential issue. The FMS process, as implemented by the U.S., is meant to ensure that the contractual documents, executed by both countries, will survive later challenges to validity based on lack of authority.

**d. Consideration**

Consideration is the price bargained for, and paid for a promise. It may consist of an act, a forbearance of an act, or a return promise. To be valid, consideration must be legally sufficient, i.e., have value. However, the courts normally will not check into the adequacy or fairness of the consideration. [Ref. 3:p. 212]

With respect to the typical LOA, consideration is exemplified by the exchange of U.S. defense articles and services for payment(s) in U.S. dollars.

**e. Lawful Purpose**

As a general rule, a contract which violates a statute is unlawful and void, and will not be enforced. In addition to statutory limitations on the right to contract, the courts have declared contracts void that are contrary to public policy.

Under the FMS process, it is incumbent upon the agencies of both governments to insure that their respective laws and policies are complied with prior to offering or accepting a given LOA. [Ref. 3:p. 212]

**f. Certainty of Terms**

The agreement must be sufficiently clear with respect to its terms (basic responsibilities, duties, methods of performance, remedies for deficiencies, etc.) to indicate that the parties intended to contract.

In order to satisfy this requirement for *certainty of terms*, the LOA makes provision for estimated prices, delivery dates, and so forth. The Standard Terms and Conditions document sets forth the standard terms relating to the obligations of the two governmental parties.

The six elements for a valid contract are found in the LOA. The LOA is the authorized document used by the USG as an offer to sell defense articles and services to a foreign country or inter-national organization. The LOA becomes a

contract when it is accepted by a representative of the purchasing country or international organization.

The LOA is subject to many conditions and restrictions referred to as "Standard Terms and Conditions." The complete "Standard Terms and Conditions" of the LOA is provided as an appendix. The most important terms and conditions, which are frequently referred to in this research, are defined below. [Ref. 3:pp. 177-180]

## **2. United States Government (USG) Obligations**

a. The USG furnishes the items being acquired by the FMS customer from its stocks and resources, or will procure them under terms and conditions consistent with DoD regulations and procedures. The Purchaser understands that selection of the contractor source to fill requirements is the responsibility of the USG. Further, the Purchaser must agree that the U.S. DoD is solely responsible for negotiating the terms and conditions of contracts necessary to fulfill the requirements in the LOA.

b. The USG uses its best efforts to provide the items for the dollar amount and within the availability cited in the LOA.

## **3. Financial Terms and Conditions**

a. The prices of items to be procured are billed at their total cost to the USG. The USG advises the Purchaser of:

1. Identifiable cost increases that might result in an overall increase in the estimated costs in excess of ten percent of the total value of the LOA,

2. Changes in the payment schedule, and

3. Delays which might significantly affect estimated delivery dates. However, USG failure to advise of the above will not change the Purchaser's obligations under the LOA.

b. The USG agrees to refund any payments received for the LOA which prove to be in excess of the final total cost.

c. The Purchaser agrees:

1. To pay to the USG the total cost to the USG of the items even if costs exceed the amounts estimated in the LOA.

2. To pay interest on any net amount by which it is in arrears on payments.

#### **4. Transportation and Discrepancy Provisions**

Reports of Discrepancy (ROD), Standard Form 364, is used in submitting claims to the USG for overage, shortage, damage, duplicate billing, item deficiency, improper identification, improper documentation, or non-shipment of defense articles and non-performance of defense services. DoD will not accept claims related to items of \$200 or less for overages, shortages, damages, non-shipment, or non-performance. Any claim received after one year from passage of title to the delivered product or from scheduled performance of the service will be disallowed by the USG. [Ref. 3:pp. 177-180]

### **C. SUMMARY**

The process of FMS management follows a logical sequence of steps over a prescribed timeline. A letter of request (LOR) initiates the FMS process. A purchaser may request either Price and Availability (P&A) data or a Letter of Offer and Acceptance (LOA). P&A data is usually needed by the foreign government for rough estimates on prices and delivery timeframes. The response times to provide P&A data is 45 days; for LOAs, it is 60 days.

The LOA, also known as an "FMS Case" is a contractual document and provides the purchasing country with all required information. The LOA, upon acceptance, is returned to the cognizant military department and to DFAS-DE/I with the required initial payment. DFAS-DE/I then provides obligation

authority to the cognizant military department to implement the FMS case.

When all items and services listed in the LOA have been shipped or performed, an FMS case is considered supply complete or delivered and is then ready to undergo the FMS case closure process.



### III. FMS PRICING, BILLING, CASE CLOSURE, AND FMS CONTRACT ADMINISTRATION BY TURKISH NAVY (TN)

#### A. FMS PRICING

##### 1. Introduction

The Arms Export Control Act (AECA), as amended, requires recovery of all costs relating to FMS. FMS pricing sets forth principles, tools, and techniques for developing an FMS price.

The methodology employed in developing an FMS price depends upon whether that price is to be placed on an LOA as a cost estimate or whether it is the price later reported in the billing system as the result of the delivery of an article or service. The prices entered on an LOA are estimates of expected costs of articles and services to be delivered in the future. The objective of these estimates, developed using cost analysis techniques, are to provide the FMS purchaser with an accurate prediction of a future cost. Prices entered into the billing system represent the actual costs of articles and services which have been delivered. These actual prices are based on the cost of the article at the time it is dropped from inventory, or the wage or salary rate at the time the service is performed.

In the case of articles coming from new procurements, the costs reported are those incurred for progress payments made to defense contractors on behalf of the purchaser. However, the exact final cost of major procurements may not be determined until the total contracts for all systems obtained under such procurements are complete. Consequently, estimates are entered into the billing system to be replaced by the actual costs as they are determined. The components of FMS price is the same whether entered on an LOA or entered into the billing system. [Ref. 3:p. 271]

It is the responsibility of the Office of the Comptroller, DoD, to establish policies and procedures involving

financial management, fiscal matters, accounting, pricing, auditing, and the balance of payments as these matters relate to security assistance. The Director of Defense Finance and Accounting Service (DFAS) is the focal point for security assistance matters within the DoD, Comptroller.

The Security Assistance Accounting Center (SAAC) is part of the Defense Finance and Accounting Service (DFAS) and is designated as the Deputate for Security Assistance at the Denver Center (DFAS-DE/I). The term "SAAC" is recognized as being synonymous with the term "DFAS-DE/I" and is used interchangeably. Some of the key functions of SAAC are listed below. [Ref. 3:p. 272]

- Operate the Defense Integrated Financial System (DIFS) for centralized DoD-wide FMS delivery reporting, collecting, forecasting, and billing.
- Prepare, review, and dispatch all FMS billing and holding account statements.
- Account for the DoD FMS trust fund.
- Perform continuing cash analysis to assure sufficient cash is available to pay DoD suppliers and MILDEPs.
- Provide assistance to, and interact with, DoD components regarding FMS logistical and financial systems, projects, policies, and procedures.
- Participate with MILDEPs in FMS reviews within and outside the United States.
- Provide obligational and expenditure authority to DoD components for the financial execution of the FMS program.
- Perform final accounting actions and render final accounting statements.
- Meet with foreign government representatives on FMS financial policies and procedures.

## **2. FMS Pricing Elements**

The following elements are considered when developing an FMS price. [Ref. 3:p. 274]

1. Cost of the item/service--purchase price, inventory value, etc.
2. Accessorial costs--for expenses of issuing and transferring materiel. This is similar to a materiel handling charge and is generally added as a percentage factor.
3. Administrative charge--for expenses of sales negotiation, procurement, accounting, budgeting, etc. (added as a percentage factor); applicable to all transactions.
4. Nonrecurring Research, Development, Test, and Evaluation (RDT&E) and production costs--for DoD investment (if applicable), on a pro-rata basis for cash sales only.
5. Contract administration costs--costs that are directly related to FMS delivery from a production contract (added as a percentage factor).

The elements of an FMS price can be combined into two major component categories: Base Price and Authorized Charges. A base price is any cost that can be identified specifically with a particular FMS case, an authorized charge is any cost not directly identified with a single FMS case. Authorized charges are often accumulated in logical cost groupings and applied as a percentage allocation to base price. In the discussion which follows, both of these categories are addressed. [Ref. 3:p. 274]

### **3. Base Price**

Personnel services are included in base price. The base price for civilians and U.S. military personnel include:

- Civilian/military salary.
- A factor for leave and holidays.

- The applicable acceleration rate for the USG share of retirement costs and fringe benefit costs.
- Actual temporary duty costs.
- Actual permanent change of station costs, if made to implement the FMS case.

The unit cost of major and principal items and common stock items from inventory is part of the base price. The unit cost is the most recent procurement cost of the series/model being sold plus the cost of any modification or improvement incorporated after production. The unit cost for used items is determined by developing a percentage relationship between useful life and life remaining. [Ref. 3:p. 276]

Defense articles procured for direct delivery are priced to recover full contract cost plus applicable surcharges included in the base price. In general, the cost principles utilized are the same as those used in pricing defense contracts covering items for DoD use. The cost of deviations from USG configurations and special technical data desired by a foreign government is included as an additional charge.

#### **4. Authorized Charges**

##### **a. Nonrecurring Costs (NRC)**

NRC are those costs funded by an RDT&E appropriation to develop or improve a product or technology either through contract or in-house effort. Also included are one-time costs incurred in support of previous production of a specified model and those incurred in support of a total projected production run.

DoD policy requires that non-USG purchasers pay a fair price for the value of the DoD nonrecurring costs. Recoupment of these costs is required on all cash sales unless a waiver has been processed.

Nonrecurring charges are currently applicable to FMS sales of significant military equipment having a nonrecurring RDT&E cost of more than \$50 million or a total production cost

of more than \$200 million regardless of the supply source. Each DoD component establishes a system to accumulate cost pools, recognizes when a cost pool meets the threshold, and calculates the NRC recoupment charge on a pro rata basis for items or technology releasable for FMS. The NRC recoupment charge computations for the sale of MDE items are submitted to the Director, DSAA for approval. [Ref. 3:p. 279]

**b. Contract Administration Services (CAS)**

These are costs incurred by contract administration offices for all of the functions required to be performed before and after a procurement contract is awarded.

The DoD Comptroller determines the applicable contract administration surcharge by dividing the cost of doing contract administration for FMS by anticipated disbursements to contractors which will be reported to DFAS-DE/I. The surcharge currently used is 1.5 percent. The LOA includes the contract administration surcharge in effect at the time of the offer. However, this is only an estimate and DFAS-DE/I will bill the surcharge in effect at the time that the bills are prepared. [Ref. 3:p. 279]

The contract administration surcharge is subject to waiver in whole or in part under the Arms Export Control Act (AECA) Section 21(h) for NATO countries and NATO Infrastructure Programs.

**c. Accessorial Costs**

Accessorial costs represent expenses incident to issues, sales, and transfers of material that are not included in the standard price or contract cost of material. Accessorial costs are applied on Package, Crating, and Handling (PCH) costs and Transportation costs.

PCH costs are those costs at DoD facilities for labor, materials, and services to take articles from storage, prepare them for shipment, and process the documentation. Standard PCH rates are:

1. 3.5 percent of the selling price for materials with a unit price of \$50,000 or less; plus
2. 1.0 percent of the unit selling price over \$50,000.

Transportation costs are the costs of DoD provided or financed transportation in the U.S. and outside the U.S.

**d. Administrative Charges**

The administrative charges include: [Ref. 3:p. 282]

- Personnel costs (except personnel costs billed directly to an FMS case).
- Temporary duty travel (except travel costs billed directly to an FMS case).
- Automated data processing costs.
- Printing costs (for FMS reports).
- Communications, utilities, and office supply costs.
- Office equipment costs.
- Rental charges for office space.
- Security assistance officer costs.

The standard administrative charge is five percent of the basic sale price for CLSSA and nonstandard articles. A nonstandard article is one which DoD does not actively manage, either because it has been retired from inventory or was never purchased for DoD components. For all other FMS orders the administrative charges is three percent of the cost or price.

**e. Attrition Charge**

An attrition charge is established to recover the cost of the total destruction of a DoD capital asset (e.g., a training aircraft) when a foreign student was in physical control of the asset or as a direct result of negligence.

The attrition charge is applicable to all training cases and is included in tuition rates.

**f. Logistics Support Charge (LSC)**

A LSC is added to FMS cases for spare parts, supplies, and maintenance of customer owned equipment to recoup an appropriate share of the cost incurred in the logistic support area.

**5. DoD Policy for FMS Pricing**

The primary sources of guidance on FMS pricing are the Financial Management Regulation, DoD 7000.14-R, Volume 15, Security Assistance Policy and Procedures [Ref. 8], and DoD Directive 2140.2, Recoupment of Nonrecurring Costs on Sales of U.S. Items.

DoD components selling material and services under the authority of AECA ensures that materials and services provided to FMS customers are priced in accordance with policies established in DoD 7000.14-R, Vol. 15, Financial Management Regulations.

DoD components are to make reasonable efforts to ensure that price estimates provided to FMS customers are a reasonable approximation of the final price.

The LOA is used to submit prices to the purchasing country. While a percentage is used in computing costs, actual dollar figures, not percentages, are reflected in the LOA. [Ref. 8:p. 154]

**B. FMS BILLING**

**1. FMS Billing Statement (DD Form 645)**

The DD Form 645, prepared by DFAS-DE/I, represents the official claim for payment by the U.S. Government referred to in the Letter of Offer and Acceptance. In addition, it furnishes an accounting to the FMS purchaser for all costs incurred under each agreement.

Billing statements are prepared and forwarded to FMS purchasers on a quarterly basis. The DD Form 645 includes

physical performance of services or delivery of material and provides current period costs as well as cumulative costs for all prior periods. The DD Form 645 also reflects the forecasted costs which relate to a given FMS case.

In addition to the DD Form 645, the purchaser is provided certain attachments, as applicable, which contain information of a more detailed nature. The following documents are included. [Ref. 3:p. 307]

**a. FMS Reply Listing to Customer Requests for Adjustments**

This is a computer printout which reflects transactions relating to the final disposition/action taken with respect to Reports of Discrepancy (ROD).

In the event customer review of the DD Form 645 and/or the supporting FMS Delivery List identifies the necessity for an adjustment, the FMS customer submits a formal request for adjustment. Requests for billing and supply adjustments for materiel and service performance are submitted to the IA. Requests for adjustments pertaining exclusively to administrative and accessorial charges are submitted to DFAS-DE/I. FMS customers submit all requests for billing and supply adjustments on a Standard Form (SF) 364, "Report of Discrepancy (ROD)," clearly indicating the specific adjustment or billing action requested. [Ref. 3:p. 308]

After resolution of RODs applicable to materiel and services, IAs report the action which is being taken to DFAS-DE/I. DFAS-DE/I will then prepare a consolidated listing of the actions taken in response to the RODs, and this listing will be mailed with the DD Form 645 to the purchaser.

**b. FMS Delivery Listing**

This is a computer printout listing the articles/services/RODs/notice of actions taken or to be taken, which have been reported to DFAS-DE/I by the Military Departments/Implementing Agencies. An FMS Delivery Listing is provided if deliveries have been reported during the Current Period of the

DD Form 645. It provides delivery information by case and item number with detailed information regarding articles/services transactions, administrative/accessorial transactions, and a summary of delivery costs for each item number.

**c. FMS Financial Forecast**

This document reflects forecasted amounts of payments due, by quarter, for the next nineteen quarters of an FMS case. It essentially portrays the same information as the LOA estimated payment schedule. [Ref. 3:p. 308]

**d. Holding Account Statement**

As a convenience to the FMS purchaser, DFAS-DE/I maintains a purchaser holding account. The holding account is a subaccount of monies not identified to a specific FMS case. The FMS customer may request DFAS-DE/I to "draw upon" its country holding account for transfers to specific cases as need arises. The holding account balances are not included in the totals of the DD Form 645. A separate statement is provided to the purchaser showing deposits and withdrawals to the holding account and is considered an off-line billing statement.

Once a case is closed, a DD Form 645 marked "final statement" is provided to the purchaser at the end of the appropriate quarter.

**2. The Billing Cycle**

DFAS-DE/I issues quarterly billing statements (DD Form 645) to FMS customers based on the Letter of Offer and Acceptance Estimated Payment Schedule prepared by the applicable Implementing Agency (IA). DFAS-DE/I bills the customer for costs related to defense articles, services, and training that have been sold pursuant to the AECA, as amended. IAs report FMS deliveries of materiel, services, training, accrued expenditures (work in process--contractor progress payments), and other related costs to DFAS-DE/I for the purpose of obtaining reimbursement. [Ref. 3:p. 305]

DFAS-DE/I obtains certain information from IAs to prepare a bill (DD Form 645) for a given FMS case. When an LOA is sent to the FMS customer, a copy is provided to DFAS-DE/I which "loads" the information in the LOA and its Estimated Payment Schedule into the Defense Integrated Financial System (DIFS). After the FMS customer accepts the "offer" and provides DFAS-DE/I with signed copies of the LOA and the applicable initial deposit, DFAS-DE/I updates the DIFS. The FMS case is implemented in the DIFS and the system is prepared for IA delivery reports. The initial deposit accompanying most FMS cases provides sufficient cash to cover disbursements from the time the case is implemented until the first billing payment due date. [Ref. 3:p. 306]

Implementing agencies report the performance and execution of the FMS program to DFAS-DE/I by use of an "FMS Delivery Transaction Report (DTR)". The DTR identifies accrued MILDEP/IA FMS expenditures and physical deliveries of articles and services. Based on the data contained in the DTR, DFAS-DE/I computes applicable surcharges and report the transactions to the purchaser through the FMS Delivery Listing attached to the DD Form 645.

### **3. Crossleveling**

Crossleveling is an accounting technique by which DFAS-DE/I transfers funds (i.e., cash receipts) from one FMS case to another FMS case for the same country. This transfer permits the FMS purchaser to minimize payments due on a billing by fully utilizing all funds previously paid on FMS cases. For example, if DFAS-DE/I has collected excess funds on a case, or a case has been closed and there are surplus funds, these funds may be transferred to other open cases, thereby reducing the amount due on the bill.

There are two methods through which crossleveling may be accomplished. In the first method, the customer conducts a cash analysis and, in a letter (usually with a payment), requests DFAS-DE/I to make specific cash transfers among

designated FMS cases. Upon receipt of the request for cash transfers between specific cases, DFAS-DE/I makes the transfers. [Ref. 3:p. 309]

The second method authorizes DFAS-DE/I to automatically crosslevel between cases based upon case needs. To initiate this method, the customer advises DFAS-DE/I of their interest to enter into a crossleveling arrangement and specifies the name and office of the individual to sign a Memorandum of Agreement on behalf of the FMS customer. DFAS-DE/I then prepares the agreement in duplicate, signs, and forwards it for the customer's signature. Upon receipt of the signed agreement, DFAS-DE/I begins crossleveling on the next succeeding billing statement.

#### **4. FMS Billing Policies**

The Arms Export Control Act (AECA), Section 21 and 22, provides legal basis for FMS billing policies and procedures. These policies and procedures are further defined and expressed, in part, in Ref. 8, Ref. 9, and in the LOA Standard Terms and Conditions discussed in Chapter II. The following policies warrant special emphasis. [Ref. 3:p. 305]

##### **a. "No Profit/No Loss" to the U.S. Government (USG)**

The USG, in procuring and furnishing items specified on the LOA, does so on a nonprofit basis for the purchaser's benefit. The purchaser agrees to pay to the USG the total costs incurred.

##### **b. Advance Collection of FMS Costs**

Unless the LOA specifies otherwise, the purchaser must agree to the USG policy of collecting funds in advance. Such advance collections shall be available to cover forecasted contractor progress payments, contractor holdbacks, potential termination charges, and deliveries from DoD inventories.

### **c. Standardized Billing Procedures**

It is DoD policy that the format, content, cycle, basis, and adjustments of FMS billing rendered to foreign governments will be standardized. Implementation of this policy is a responsibility of the Defense Finance and Accounting Service-Denver Center, Deputate for Security Assistance (DFAS-DE/I) [or Security Assistance Accounting Center (SAAC)].

## **C. CASE RECONCILIATION AND CLOSURE**

### **1. Case Reconciliation**

Case reconciliation is a series of actions which commence with the implementation of an FMS case and continue through case execution and conclude when the case is closed. Several important actions facilitate case closure. These are:

1. Establishing a comprehensive file of all transactions pertaining to the case.
2. Recording every financial transaction and cost.
3. Ensuring case designators are recorded in all financial transactions. [Ref. 8:p. 1305-1]

Those cases where reconciliation cannot be achieved are referred to the DoD Executive Foreign Military Sales Reconciliation and Case Closure Board.

### **2. Case Closure**

A FMS case becomes a candidate for closure when:

1. All ordered items have been physically delivered.
2. All ordered services have been performed.
3. All Reports of Discrepancy (RODs) have been closed.
4. Financial requirements are complete.
5. Records maintained by the implementing agency (IA) and DFAS-DE/I are in agreement. [Ref. 3:p. 314]

A FMS case is considered closed when DFAS-DE/I issues a final statement of account (DD 645) to the customer. DFAS-DE/I can issue a final bill only after the implementing agency (IA) has submitted a case closure certificate to DFAS-DE/I. The IA and DFAS-DE/I will close a case in a lengthy process called case reconciliation. In order to ensure that all supply and financial transactions have been resolved with DFAS-DE/I as well as the IA, the customer should be an active participant in the case reconciliation process. The DoD case manager is the primary individual responsible for case closure. For some cases (e.g., blanket order cases) this responsibility is delegated to the ILCO, where the ILCO will take the lead in initiating and coordinating the reconciliation process. [Ref. 3:p. 165]

Current policy states that all cases should be reported closed to DFAS-DE/I within 24 months of becoming supply complete, unless there are significant case procurement actions pending final liquidation or final disbursement. These final procurement disbursements are referred to as unliquidated obligations or ULO. A ULO condition will occur when FMS requirements ordered against a long running domestic USG contract have been delivered, however, the final disbursements have not been generated. The difference between the delivered value of the item and the final contract price is called the ULO.

Accelerated case closure procedures were implemented DoD-wide by DSAA in June 1992 to alleviate the lengthy closure process associated with ULO and long running contracts supporting FMS cases. Customer participation in these procedures is optional except for those countries which are recipients of FMF funds where participation is mandatory. Accelerated closure procedures require that the delivered value of an item be adjusted to equal the estimated final contract price. This difference, the ULO, along with the delivered value is billed and collected from the FMS customer.

The ULO collection is placed by DFAS-DE/I into a customer-owned, country level case closure suspense account.

The customer is given a final bill indicating that the case is closed. Subsequent post closure case disbursements for the ULO will be processed against the country closure suspense account, there-by allowing cases closed by the accelerated process to remain "closed." Customers will receive regular suspense account statements. If the accrued balance of the suspense account exceeds anticipated requirements, the customer can receive a refund. However, if the account balance is negative by \$100,000 or more for six months then the customer will be billed for the entire balance owed. [Ref. 3:p. 165]

While these cases are closed as far as the customers are concerned, the cases continue to be accounted for in both the MILDEP and DFAS-DE/I records. Final closure in DoD records only occurs when all contracts are completely settled. The closure certificate process under these accelerated procedures are in two phases. For those cases closed with unliquidated obligations, an interim closure certificate is submitted. Based on this interim certificate, DFAS-DE/I will issue a final statement of account to the FMS customer. Subsequently, a final closure certificate is submitted by the IA when all contract issues are finalized and all obligations liquidated. [Ref. 3:p. 314]

#### **D. FMS CONTRACT ADMINISTRATION BY TURKISH NAVY**

##### **1. Introduction**

All foreign procurements by Turkish Armed Forces are conducted according to the Foreign Procurement Regulation, Ministry of National Defense, MSY/310-1, 1993. The Ministry of National Defense is ordinarily responsible for all foreign procurement of Turkish Armed Forces according to the Law #1325, Ministry of National Defense Responsibilities and Organization Act. Under certain conditions, procurement

authority may be delegated to the Navy, Air Force, and Army by the Ministry of National Defense. [Ref. 10:pp. 47-50]

Procurement regulations do not include cost-type contracting. Only fixed-price type contracts are allowed and contract price must be fixed when the contract is awarded. These requirements are contradictory to U.S. FMS contractual agreements explained in Chapter II. A special exemption is provided by Law #2886, Procurement Act, 1983, so that the U.S. FMS process and contractual agreements can be implemented by Turkish Armed Forces. [Ref. 11:p. 21] Turkey does not have special regulations for procurement through the U.S. FMS process; instead, the U.S. FMS regulations and procedures are used by the Turkish Armed Forces to administer and implement FMS contracts.

Each year, agencies (Navy, Army, and Air Force) send their planning and budgeting requests to the Turkish General Staff for validation and to the Ministry of National Defense for approval. Once the requests are approved by the Ministry of National Defense, the Turkish General Staff appropriates FMS funds to agencies according to the approved FMS budget. Then, agencies start procurement of the planned projects using the FMS procedures explained in Chapter II and administer the contracts. [Ref. 10:p. 48]

## **2. Turkish Navy Organization for FMS**

All FMS procurement requests, originated by user units or supply centers, are gathered in the Planning and Principles Department of the Turkish Navy. The Planning and Principles Department is responsible for preparing and presenting program and budget needs, including updates and revisions, to the Turkish General Staff for review and validation and to the Ministry of National Defense for approval. [Ref. 12:p. 2]

The Foreign Procurement Department, under the command of the Chief of Logistics of the Turkish Navy, is responsible for the procurement of approved and budgeted programs. Primary

responsibilities of the Foreign Procurement Department include: [Ref. 12:pp. 1-2]

- Coordinate in-house actions among central procurement, field offices, audit agencies.
- Provide contract and administrative services.
- Keep records of all FMS related documentation.
- Correspond with outside agencies and units, including U.S. agencies, related to FMS.
- Request Price and Availability (P&A) data, and Letter of Offer and Acceptance (LOA) according to the FMS process.
- Provide program and status reports to in-house units.
- Participate in the Turkish Navy Case Management and Reconciliation Reviews meeting held by U.S. Navy International Logistics Control Office (NAVILCO), Philadelphia, PA.

The FMS section of the Foreign Procurement Department has two officer and two petty officer billets, and has no civilian billets in its structure.

Correspondence with all U.S. agencies related to the U.S. FMS are carried out by the Office of Defense Cooperation (ODC) Turkey. Joint United States Military Mission for Aid to Turkey (JUSMMAT) had been the name for ODC Turkey since 1958. In May 1994, JUSMMAT was renamed ODC Turkey.

ODC Turkey is often the hub of security assistance activities, serving as the focal point between the Turkish General Staff, the Ministry of National Defense, the U.S. Embassy in Ankara, DSAA, and U.S. Military Departments (MILDEPs).

The Navy Directorate (NAD) of ODC is the point of contact for the Turkish Navy for all security assistance activities including FMS. In addition to maintaining close liaison with the Turkish Navy, NAD works with U.S. Naval Air and Sea Systems Commands, the Naval Education and Training Security

Assistance Field Activity, U.S. Embassy in Ankara, and the Navy International Programs Office (Navy IPO) in Washington, DC. NAD manages over 250 FMS cases worth almost one billion dollars. [Ref. 7:p. 10]

The Inventory Control Center, located in Golcuk, which is the main naval base of the Turkish Navy, is responsible for all FMS spare parts procurement and open on a yearly basis. Inventory Control Center keeps records of all spare parts stock present in the Turkish Navy. Units, including ships, provide necessary inputs to the center. When inventory levels fall below a specified level, the Inventory Control Center orders the spare parts directly from NAVILCO. Correspondence related to spare parts procurement through U.S. FMS is made by this center. It also provides units with progress and status reports related to spare parts orders. [Ref. 12:pp. 1-2]

The FMS Liaison officer, stationed in NAVILCO Philadelphia, is the point of contact for spare parts orders and provides necessary inputs to U.S. agencies. When a need is urgent, the liaison officer coordinates the request in the U.S.

#### **E. SUMMARY**

The methodology employed in determining an FMS price depends on whether the price is to be developed before the fact as an estimate on the LOA, or after the fact as the reporting of a cost in the billing system.

The LOA is the primary document used to transit FMS prices to the purchasing country. Elements used in calculating FMS prices may include, but are not limited to, the cost of the item; nonrecurring RDT&E and production costs; contract administration costs; accessorial charges; and administrative charges.

The above charges can be combined into two categories: base price and authorized surcharge. Base prices include the cost of the item or service, while the authorized surcharge

represents a percentage of the base prices, usually a pro-  
ration of the value of the base price. Authorized surcharges  
are assessed in order that the FMS customers pay a fair share  
of the overhead and other costs that have been incurred by the  
USG as a result of providing goods and services.

The Arms Export Control ACT (AECA), as amended, provides  
the legal basis for FMS billing policies and procedures. FMS  
billing provides a mechanism for complying with the require-  
ments of the AECA in that FMS is to be conducted in a "no  
profit--no loss" manner and that payments are to be made in  
advance of USG expenditures on the purchaser's behalf.

Implementing agencies report the cost of DoD services,  
inventory, and new procurement sales to DFAS-DE/I. Based on  
the data contained in these reports, DFAS-DE/I computes the  
charges and bills FMS customers for accrued expenditures and  
those costs resulting from the application of various  
surcharges.

The basic FMS billing document is the DD Form 645, which  
is prepared at the end of each calendar quarter. The DD Form  
645 serves both as a billing document and a statement of  
account. Numerous attachments, as applicable, accompany the  
DD Form 645, to include the "FMS Delivery Listing," the "FMS  
Reply Listing to Customer Request for Adjustments," the "FMS  
Financial Forecast," and the "Holding Account Statement."

A case is considered delivered or supply complete when  
all articles and services contracted for on the LOA have been  
delivered or performed by the implementing agency. Case  
closure is then undertaken. A case is considered close when,  
in addition to final delivery or performance, all financial  
transactions, including collections, have been completed and  
the customer has received a final statement of account for the  
case.

The Turkish Navy (TN) utilizes U.S. FMS procedures and  
regulations to implement and administer FMS cases. Although  
some of the "Standard Terms and Conditions" included in the

LOA are contradictory to the national procurement laws and regulations of Turkey--the most important ones being: (1) contracting based on estimated prices, and (2) the full advance payment before a contract is performed, exemption from the national laws is provided by Law #2886 to give authority to the Turkish Armed Forces so that the LOA can be implemented.

Issues and problems related to the FMS pricing, billing, contract closure, and contract administration by the Turkish Navy from the Turkish Navy's point of view, are discussed and analyzed in Chapter IV.



## IV. ANALYSIS

### A. PRICING

#### 1. Policy

The U.S. FMS pricing policy requires the purchasing country to accept the contract based on estimated prices. The prices entered on an LOA are estimates of expected costs of articles and services to be delivered. The objective of these estimates is to provide the FMS purchaser with an accurate prediction of future cost based solely upon best efforts of the USG. The policy also requires the FMS customer to pay to the USG the total cost of the items even if costs exceed the amounts estimated in the LOA.

The USG uses its best effort to advise the purchaser of identifiable costs that might result in an overall increase in the estimated costs in excess of ten percent of the total value of the LOA. USG failure to advise of cost increases does not change the purchaser's obligation to pay the total cost to the USG.

Since the LOA requires the total cost to the USG to be paid by purchaser, it is similar to a cost-reimbursement contract used by the USG in which the contractor receives no fee. Cost-reimbursement contracts are suitable for use only when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-priced contract. [Ref. 14:p. 16-6]

According to the Federal Acquisition Regulation (FAR) 16.301-3, when USG is a buyer, a cost-reimbursement contract may be used only when:

- The contractor's accounting system is adequate for determining costs applicable to the contract; and
- Appropriate Government surveillance during performance will provide reasonable insurance that efficient methods and effective cost controls are used.

If the purchasing country utilizes the same criteria as the USG, it seems obvious that a cost-reimbursement contract is not suitable for the purchasing country because:

- The purchasing country can't know whether the USG accounting system is adequate for determining costs applicable to the LOA.
- The purchasing country has no surveillance during performance that provides reasonable assurance that efficient methods and effective cost controls are used.

The pricing policy used by the USG when it is a seller is opposite to the pricing policy used when it is a buyer. The USG controls and audits the cost to the possible extent when it is a buyer, but requires the purchasing country to accept its prices without any control or audit.

## **2. Price Estimates**

The USG is required to make a reasonable effort to ensure that price estimates provided to FMS customers are a reasonable approximation of the final price. [Ref. 8:p. 154] A FMS customer does not know the criteria for reasonable effort and reasonable approximation. [Ref. 15]

The payment schedule stated in a LOA is based on estimated prices. Estimated prices only become certain after an article or service of the LOA is provided. Since payments are made based on estimated prices, over-estimated prices create excess funds until the price is certain.

Since 1991, the primary issue for the Turkish Navy (TN) has been excess case funds due to advance payments based on estimated prices. During all Turkish Navy Case Reconciliation meetings, held by NAVILCO, Philadelphia, PA, since 1991, emphasis is placed on the return of excess funds paid by the Turkish Navy (TN). Estimated excess funds were as follows:

YEAR	AMOUNT
1991	\$3,349,000 [Ref. 16:p. 3]
1992	\$5,984,108 [Ref. 17:p. 2]
1993	\$2,152,716 [Ref. 18:p. 2]
1994	\$6,192,989 [Ref. 19:p. 4]
1995	\$8,215,152 [Ref. 20:p. 3]

The Turkish Navy FMS yearly budget is around \$50 million. [Ref. 15] When comparing the excess funds to the yearly budget, excess fund to total budget ratio ranges from 4.3 percent to 16.4 percent. That is why the excess fund issue is very important to the Turkish Navy. These overpayments not only cause planning and budgeting problems but negatively affects the effective use of FMS funds.

Dollar estimates cited on Price and Availability (P&A) data, the LOA and actual prices cited on DD Form 645 are usually different from each other. When the issue was discussed in the 1994 Turkish Navy Case Reconciliation Review Meeting, Navy IPO reminded the Turkish Navy that P&A data/LOA values are "estimated" and Program Managers are making every effort to ensure the most accurate values. Navy IPO also stated the U.S. policy of securing sufficient funds in the early stages versus the problems caused by insufficient funding in early program development. [Ref. 19:p. 2]

Unless more accurate price estimates are available to FMS customers, problems inherent to estimated prices will continue to exist.

### **3. Line Item Pricing**

It is U.S. FMS pricing policy that a single selling price for an LOA shall be established unless DSAA has authorized provisions of more detailed cost information to an FMS customer. It is not a normal FMS practice to provide a

detailed description of the components of cost included in estimated prices for line items on LOAs. [Ref. 9:p. 1307-1]

Table 1 and Table 2 are examples of LOA cost elements. In Table 1, item 3 states that the estimated price for supply support is \$500,000. What supply support includes is not clearly stated and not priced. Both item 4 and item 5 include technical assistance. The difference between item 4 and item 5 and what technical assistance covers is not known by the customer. Item 6 is program management support and detailed cost elements are not known by the FMS customer. In Table 2, for instance, spares and support is not listed separately and not priced separately. In fact, all the items in Table 2 do not clearly state what service will be provided.

Since the information on a LOA does not provide cost elements in acceptable detail, the FMS customer usually does not know the exact services and articles which will be provided by the U.S. For instance, in Table 2, what spare parts will be provided is known to the Turkish Navy only when those items are delivered? The Turkish Navy has no control over technical assistance, engineering assistance, program management support, travel, training, documentation, etc. as stated in Table 1 and Table 2. How they are priced and what they cover is only known to the USG?

This doesn't mean that USG officials are not doing their jobs properly, nor is it implied that this is an ethical issue. The purpose of the above is to state that the FMS customer needs more information on a LOA to specify actual services performed and determine when service is completed.

## **B. BILLING**

### **1. Policy**

The USG policy requires the purchaser to pay to the USG the total cost (of the items and services) to the USG even if costs exceed the amounts estimated in the LOA. DFAS-DE/I

ITEM NO.	DESCRIPTION	PLANNED \$ PER LOA
1	Torpedo MK46/5	\$2,224,670
2	Containers	50,750
3	Supply Support	500,000
4	Eng/Tech Assistance	215,100
5	Tech Assistance	76,125
6	Program Management Support	75,150
	Net Case Value	\$3,141,795

Case Identification:	TK-P-AFX	Implementation Date:3/92
Description:	Torpedo MK46 Mod 5	Supply Completion Date:2/95
Total Case Value:	\$3,246,548	Case Closure Date:3/97
Paid to Date:	\$3,246,548	

**Table 1. TK-P-AFX Financial Status**  
[Ref. 21:Section 1]

ITEM NO.	DESCRIPTION	PLANNED \$ PER LOA
1	MK 540 Test Set, Spares and Support	\$6,327,640
2	Training	130,000
3	Technical Support	733,000
4	Travel	85,750
5	Documentation	100,000
6	Site Survey	39,000
	Net Case Value	\$7,415,390

Case Identification:	TK-P-BEP	Implementation Date:8/86
Description:	MK540 Test Set	Supply Completion Date:12/94
Total Case Value:	\$7,678,035	Case Closure Date:12/96
Paid to Date:	\$7,678,035	

**Table 2. TK-P-BEP Financial Status**  
[Ref. 21:Section 1]

issues quarterly billing statements (DD Form 645) to the FMS customer based on the LOA Payment Schedule prepared by the applicable Implementing Agency (IA). The DD Form 645 represents the official claim for payment by the USG. Payments are required 90 days in advance of the time DoD plans deliveries or incurs expenses on behalf of the purchaser. The USG policy also requires the purchaser to pay interest on any net amount by which it is in arrears. Interest is calculated on a daily basis.

When the USG is a buyer, the Federal Acquisition Regulation (FAR) does not include full advance payment. But it is required by the USG when it is a seller. When the USG is a buyer, the payment schedule is not based on future deliveries.

## **2. Interest Payment**

Each quarterly billing statement requires the purchaser to pay, in advance, for all deliveries and services scheduled for the following quarter. In practice, however, there are some examples where the payment schedule was not congruent with material deliveries. [Ref. 16:p. 1] In fact, it is usual that advance payments on all the Turkish Navy cases far exceed material deliveries: over 95 percent of all Turkish Navy cases are fully collected. Some cases were collected at total case value even though no deliveries had been processed. [Ref. 19:p. 2]

The Turkish Navy feels that in situations when payments are made long before any material is delivered, they inappropriately forfeit interest credits. They would like to be reimbursed interest credit in such cases. [Ref. 19:p. 1]

Even though USG policy requires the purchaser to pay interest on any net amount by which it is in arrears, the USG does not pay any interest to the purchaser when payments are made long before the 90-day requirement. [Ref. 15]

## **3. Forced Billing**

It was Defense Logistics Agency (DLA) policy until 1993 to bill customers for shipments of material whether shipment

had occurred or not and where the total requisition value was less than \$200.00. [Ref. 22:p. 2]

The LOA "Standard Terms and Conditions" require the purchaser to use the Report of Discrepancy (ROD), Standard Form 364, when submitting claims to the USG for non-shipment of defense articles. DoD will not accept claims for non-shipment related to items of \$200.00 or less. Any claim for non-shipment received after one year from passage of title to the article or initial billing, whichever is later, will be disallowed by the USG unless the USG determines that unusual and compelling circumstances justify consideration of the claim.

Due to the above stated requirement, FMS customers are not entitled to report discrepancies for non-shipment of material when the total value was less than \$200.00 even though the material is not shipped but billed as shipped. This is called "Forced Billing."

Preliminary analysis indicated that the instances of "Forced Billing," although not representing a large amount of money, were frequent. [Ref. 22:p. 2]

DoD acknowledges the problem but cannot yet resolve it. NAVILCO, Philadelphia produced a report showing "Forced Billing" cases and FMS customers are in the process to identify them. [Ref. 23:p. 3]

#### **4. Double Billing**

The pricing of stock fund material changed effective 1 October 1990. Prior to 1 October 1990, the pricing objective of stock-funded items from inventory for sales was to recoup the acquisition cost of the item(s), plus first destination transportation charges and pro rata share of normal inventory loss. [Ref. 3:p. 276]

During this time, funding for the operational costs of material management and distribution of stock-funded material was not from the stock fund but rather from another account-operation and maintenance. For FMS sales, recoupment of the

operational costs of material management and distribution was through the application of authorized accessorial charges; i.e., packing, crating, and handling (PCH) and the Logistics Support Charge (LSC). For FMS material transported inland, CONUS transportation costs were recouped by applying a percentage to the price of the item. [Ref. 3:p. 277]

Beginning with FY91, DoD stock funds were consolidated into the Defense Business Operations Fund (DBOF) and commenced funding all costs incurred by inventory control points and major supply depots related to providing supplies and materials to customers. Therefore, the standard DBOF price now includes those costs indicated in the above pricing objectives and those associated with the authorized accessorial charges. [Ref. 3:p. 277]

As a result, PCH, LSC and transportation to the CONUS pickup points of the FMS customer's freight forwarder and/or port of embarkation, are no longer added to the basic price of DBOF material.

Since 1991, activities providing DBOF material to FMS customers continued to ship materials to the freight forwarder and/or port of embarkation on "collect" status instead of "prepaid" status, and the freight forwarder charged the FMS customer for the inland CONUS transportation costs. This is called "Double Billing." [Ref. 24:p. 1]

Double Billing cases were at the highest levels in 1992 and 1993. The problem is still continuing in lesser amounts, even though DoD acknowledges the problem. [Ref. 25:p. 5] The FMS customer claims the reimbursement of the extra charges caused by "Double Billing" by using ROD.

## **C. CONTRACT (FMS CASE) CLOSURE**

### **1. Closure Considerations**

Historically, case closure has been a difficult process, taking anywhere from five to ten years after a major weapon systems case has become complete. [Ref. 3:p. 166]

There are many reasons to emphasize case closure. If a case is open it implies that all necessary actions have not yet occurred. Open cases necessitate open and often voluminous computer data records as well. Until the case is closed, both the USG and the purchasing country budget and financial records cannot be totally reconciled. Furthermore, an open case is a matter of continuous concern to the purchasing country which must ensure that funding is available for the case within the rules of the country's domestic appropriation/budgeting system.

It is important that the case manager, DFAS-DE/I, and the customer complete and reconcile the individual case transactions as soon as possible. It is not uncommon for a case to generate thousands of requisitions and procurement actions. Closing out all transactions requires aggressive planning and follow-up. Lack of management emphasis, audit trails, and planning for closure early in the life of an FMS case have been consistent inhibitors to effective closure. [Ref. 3:p. 166]

Case reconciliation should be done on a periodic basis, beginning soon after a case is implemented, probably during FMS case or program reviews. A concerted effort with case closure as the goal should be initiated and tracked as soon as the case becomes supply complete.

## **2. Case Closure Time**

A long standing mutual concern between DoD and FMS customers is the length of time required to close a FMS case after it is supply complete (all material and services provided to the customer). [Ref. 26]

Through many years of experience, the DoD purchasing officials have determined that it is more efficient and cost effective to negotiate a single contract and add new contract lines as additional purchases are required, rather than to negotiate separate contracts for each purchase. While DoD negotiates lower prices by combining purchases and increasing

purchase quantities, the practice contributes significantly to the delay in closing FMS cases. [Ref. 27:p. 1]

Many FMS cases on which all material has been delivered are in open status for many years because of a small dollar value of potential contract liability which cannot be determined until all contracted efforts are completed, final audits made, and final costs are negotiated.

New procedures, called accelerated case closure procedures, were implemented DoD wide by DSAA in June 1992 to reduce the length of time required to close a FMS case, supported with contract(s), after the case is supply complete. When FMS cases are supported with contracts, final costs are not known until the supporting contract(s) are closed, even though a specific FMS case may have been supply completed. The revised procedures are intended primarily for FMS cases supported by long running contracts. Contracts typically supporting both U.S. forces and the FMS customer requirements and contract closure cannot begin until the final ordered material/service has been delivered/performed by the contractor, the DSAA has performed the final audit, and the contract administration office has negotiated the final contract price. The negotiations are normally for the general and administrative overhead rates of the contractor. When the final contract price has been determined, which can take five or more years, it is then distributed among all customers of the contract. The FMS case can then be closed. [Ref. 27:p. 2]

Use of the revised procedures shortcuts this long process by using the actual disbursement, and the unliquidated obligation values recorded in the implementing activity accounting records to determine the final contract price for the FMS case. DSAA's objective is to close cases within 12 to 24 months after a case is supply complete. This time allows for Reports of Discrepancy (RODs) to be processed, any required

price adjustments to be made, and the value of unliquidated obligations to be determined. [Ref. 28:p. 1]

There are three primary benefits to the FMS purchaser resulting from the new procedures:

1. The FMS case will be closed faster, reducing administrative, logistical and financial workloads.
2. Closure value and final obligation value will be settled earlier, reducing the budget concerns of the FMS customer.
3. Collection in excess of the final case closure billing value will be refunded sooner allowing the FMS customer to use the money for other important purposes.

For the FMS cases not supported by a contract, case closure time is mainly dependent on ROD processing and price adjustments. Since the FMS customer is entitled to submit a claim by ROD within one year of acceptance, FMS cases cannot be closed in one year. The other process that negatively affects the case closure time is price adjustments required in order to change estimated prices to actual prices. DoD objective of one to two year case closure time after the case is supply complete seems to be reasonable.

### **3. Turkish Navy FMS Cases**

Table 3 lists 39 Turkish Navy (TN) FMS cases which were closed in 1994 and 1995, or planned to be closed in 1995. Average time between supply completion date and case closure date is 3.4 years. The 3.4 year timeframe is a very long closure time for the Turkish Navy when you compare it to the three to six month closure time for domestic procurements in Turkey. [Ref. 15] Since Turkish procurement regulations do not have cost-reimbursement type contracting, domestic contract time is three to six months. If no claims are issued

Table 3. Material Complete FMS Cases  
[Ref. 21:Section 6]

FMS CASE	DESCRIPTION	IMPLEMENTATION DATE (MONTH/YEAR)	SUPPLY COMPLETION DATE (MONTH/YEAR)	CASE CLOSURE DATE (MONTH/YEAR)	TIME BETWEEN SUPPLY COMPLETE AND CASE CLOSURE
TK-P-ADJ	Torpedo MK46 Mod 5	2/84	9/93	9/95	2.0 years
TK-P-ADZ	Torpedo MK46 Mod 5	10/85	4/92	5/94	2.1 years
TK-P-AEC	EOD Equipment	1/86	12/91	10/94	2.8 years
TK-P-AEH	Torpedo MK46 Mod 5	8/86	4/92	9/94	2.4 years
TK-P-AEP	Torpedo Exercise Head	6/86	8/91	9/94	3.1 years
TK-P-AEX	Torpedo MK46 Mod 5	4/88	7/92	7/94	2.0 years
TK-P-AFF	Underwater Mine Material	2/90	4/93	4/95	2.0 years
TK-P-BFI	Receiver, Underwater Acoustic	6/87	9/89	5/94	4.7 years
TK-P-BFP	Transducer Test Facility	5/89	4/93	4/95	2.0 years
TK-P-BFZ	Torpedo Trainers	2/90	8/92	8/94	2.0 years
TK-P-BGD	ECP 4098 Mod Kits	5/90	8/93	8/95	2.0 years
TK-P-BGF	ASROC IMA Test Equipment	5/90	5/93	4/95	1.9 years
TK-P-BGT	Frigate Program Management	8/82	11/85	6/94	10.6 years
TK-P-GCY	Program Management Office	11/85	9/86	6/94	7.8 years
TK-P-GDG	Program Management Office	11/86	3/88	11/94	8.7 years
TK-P-GDM	Program Management Office	6/88	11/90	5/94	3.5 years
TK-P-GDY	Calibration of Test Equipment	11/90	4/93	4/95	2.0 years
TK-P-GFJ	Shipyard Modernization	1/93	12/93	12/95	2.0 years

Table 3. (Continued)

FMS CASE	DESCRIPTION	IMPLEMENTATION DATE (MONTH/YEAR)	SUPPLY COMPLETION DATE (MONTH/YEAR)	CASE CLOSURE DATE (MONTH/YEAR)	TIME BETWEEN SUPPLY COMPLETE AND CASE CLOSURE
TK-P-GEB	Program Management Office	4/90	9/92	11/94	2.3 years
TK-P-GEN	MK46 Torpedo Support	10/90	6/93	6/95	2.0 years
TK-P-JAE	Torpedo MK46 Mod 5	12/89	7/92	9/95	3.2 years
TK-P-LBI	Track II Frigate Program	2/83	12/93	11/95	1.9 years
TK-P-LBL	AN/SLQ-25 (NIXIE)	1/83	6/88	6/94	6.0 years
TK-P-LBV	Camera System	11/84	12/85	5/94	8.4 years
TK-P-LCD	ORDALT 9777	6/85	6/89	5/94	4.9 years
TK-P-LCK	Industrial Plant Equipment	2/86	3/94	12/95	1.8 years
TK-P-LCO	Ordalt Kits	6/86	9/93	9/95	2.0 years
TK-P-LDF	IMA Tools	10/85	8/91	5/94	2.8 years
TK-P-LDS	Industrial Plant Equipment	3/86	8/88	5/94	5.8 years
TK-P-LDLI	Underway Replenishment	1/86	8/88	6/94	5.8 years
TK-P-LEG	GMOTS	9/86	8/93	8/95	2.0 years
TK-P-LER	Test Set, MK303 Mod 1	8/87	3/92	6/94	2.3 years
TK-P-LES	Asroc Launcher Equipment	7/87	6/91	6/94	2.0 years
TK-P-LEOS	Rescue Equipment	4/88	9/92	9/94	2.0 years
TK-P-LFR	EOD Components	3/89	12/92	12/94	2.0 years
TK-P-LFS	Zodiac Boats	3/89	2/92	6/94	2.3 years

Table 3. (Continued)

FMS CASE	DESCRIPTION	IMPLEMENTATION DATE (MONTH/YEAR)	SUPPLY COMPLETION DATE (MONTH/YEAR)	CASE CLOSURE DATE (MONTH/YEAR)	TIME BETWEEN SUPPLY COMPLETE AND CASE CLOSURE
TK-P-LGT	Night Vision Device	4/90	2/92	7/94	2.4 years
TK-P-LHH	Asroc Launcher MK112	12/90	3/92	9/94	2.5 years
TK-P-RBQ	Undersea Mine Material	3/82	12/90	10/94	3.8 years

Number of Cases:

39

Average Time Between Implementation Date and Case Closure Date:

7.5 years

Average Time Between Supply Completion Date and Case Closure Date:

3.4 years

Average Time Between Implementation Date and Supply Completion Date:

4.1 years

Average Time Between Supply Completion Date and Case Closure Date:  
(For Cases Supply Completion Date is after June 1992)

2.1 years

Average Time Between Supply Completion Date and Case Closure Date:  
(For Cases Supply Completion Date is after June 1992)

4.5 years

by either party when the contract is supply complete and accepted by the Turkish Navy, the main issues that remain are the completion of payments and documentation.

Looking at the average case closure time, considering the accelerated case closure procedures implementation date in June 1992, it can be seen that for the cases which the supply completion date is after June 1992 the average case closure time is 2.1 years, versus the average closure time of 4.5 years for cases which the supply completion date is before June 1992. The 2.1 year average case closure time is almost within the DoD objective of one to two years. This may indicate that accelerated case closure procedures have really been effective and have reduced the case closure time for the Turkish Navy.

#### **D. FMS CONTRACT ADMINISTRATION BY THE TURKISH NAVY**

Under the FMS system, the USG and the Turkish Government enter into and sign an international agreement, the FMS Letter of Offer and Acceptance (LOA), which specifies the terms and conditions of the sale. Thereafter, except for items supplied directly from DoD inventory, the USG buys the desired item or weapon system from the U.S. manufacturer on behalf of the Turkish Government, employing essentially the same procurement criteria as if the item/system was being purchased for U.S. needs. The USG, not the Turkish Government, selects the source and manages the awarded contract, consistent with the provisions of the Federal Acquisition Regulation (FAR) and LOA.

The Navy International Program Office (Navy IPO), Navy International Logistics Control Office (NAVILCO), Defense Logistics Agency (DLA), Defense Security Assistance Agency (DSAA) Defense Security Assistance Agency (DSAA), Defense Finance and Accounting Service - Denver Center, Deputate for Security Assistance (DFAS-DE/I), Navy Implementing Agencies, and the Office of Defense Cooperation (ODC) Turkey are the

primary U.S. agencies that manage and administer Turkish Navy's IMS contracts on behalf of USG. The Navy Foreign Procurement Department, Navy Inventory Control Center, Golcuk, FMS Liaison Office, Philadelphia, PA, and the Naval Supply Attache Office, Washington, DC are the primary Turkish agencies that manage and administer FMS contracts on the behalf of the Turkish Navy.

The Turkish Navy uses U.S. FMS regulations and manuals as reference documents to manage and administer FMS cases. The Organization and responsibilities of FMS related agencies of the Turkish Navy are determined and regulated by the Turkish Naval Forces Command's Executive Orders.

FMS cases are primarily managed and administered by U.S. agencies. If the FMS case is about service requirements from the U.S. then the case is completely managed by the U.S. agencies. If the FMS case is about defense articles or major weapon systems requirements, the case is managed and administered by U.S. agencies, except for the transfer of the items from CONUS to Turkey, acceptance of the items providing required reports and standard forms to U.S. agencies and making payments. After acceptance, the case is primarily managed by U.S. agencies. Starting from the acceptance of the LOA, U.S. agencies provide data related to status of FMS requisitions, the movement of the requested material through the supply system, financial status of the FMS cases, and billing statements and forecast reports to the Turkish Navy on a quarterly basis.

Based upon the data, statements and reports provided by U.S. agencies, the Turkish Navy agencies:

- Verify that items in FMS Delivery list are delivered.
- Accept the delivered items.
- Review and verifies funding requirement.

- Develop a financial plan to meet payment requirements.
- Provide status, program financial and forecast reports to in-house officer.
- Submit ROD for any claims.
- Correspond with U.S. agencies regarding problems.
- Maintain a complete chronological history.
- Maintain necessary case files.

Issues encountered by Turkish agencies are mostly due to uncertainties related to administering a contract that is based on estimated prices, estimated delivery dates and best effort of contractor and using U.S. FMS manuals, documents, and reports as reference documents.

Estimated prices necessitate continuous and updated financial planning in order to meet the financial requirement of the cases and to transfer excess funds to other important programs. Estimated delivery dates, on the other hand, necessitate continuous logistical planning to meet the user's need if material is not available due to late delivery.

Effective use of English manuals by Turkish officials mostly depends on the language level and training of the user. It is not an understatement to say that FMS has a language of its own, and that learning and communicating the numerous acronyms, the special terms and the organizational symbols often takes a long time even for native English speakers.

The Turkish Navy does not have official training for FMS procedures. The total number of personnel working directly with FMS is five officers and four petty officers. They are usually trained on the job by experienced personnel and are assigned to posts in the U.S., FMS Liaison Officer, Philadelphia, PA, Naval Supply Attache Office, Washington, DC, to overcome the difficulties related to language barriers and training. It is also the Turkish Navy's policy to use the

personnel so trained as long as possible in the FMS related agencies.

#### **E. SUMMARY**

The U.S. FMS policy requires the purchasing country to accept the contract based on estimated prices. The USG uses its best effort to advise the purchaser of identifiable costs that might result in an overall increase in estimated costs in excess of ten percent of the total value of the LOA. USG failure to advise of cost increases does not change the purchaser's obligation to pay the total cost to USG.

The primary issue for the Turkish Navy (TN) has been excess case funds due to advance payment based on estimated prices. Since 1991, the amount of excess funds is 4.3 to 16.4 percent of the FMS yearly budget of Turkish Navy.

In some cases, the FMS customer does not have the specifics of actual services performed by the U.S. since the information on the LOA is stated by general terms but not in detail.

Payments are required 90 days in advance of the time DoD plans deliveries or incurs expenses on behalf of the purchaser. The USG policy also requires the purchaser to pay interest on any net amount by which it is in arrears on payments.

FMS customers are not entitled to submit ROD for non-shipment of material when the total value is less than \$200.00 even though the material is not shipped but billed as shipped.

Double billing cases were at the highest level in 1992 and 1993. The problem is still continuing even though DoD acknowledges it.

A long standing mutual concern between DoD and FMS customers is the length of time required to close a FMS case after it is supply complete. Many FMS cases on which all material has been delivered are in open status for many years by a small dollar value of potential contract liability which

cannot be determined until all contracted efforts are completed, final audits are made by DSAA and final costs are negotiated. When the final contract price has been determined, which can take five or more years, it is then distributed among all customers of the contract. The FMS case can then be closed.

The average case closure time for the Turkish Navy has decreased to 2.1 years from 4.5 years, after accelerated case closure procedures were implemented in June 1992.

Issues encountered by the Turkish agencies, when administering a FMS case, are mostly due to uncertainties related to administering a contract that is based on estimated prices, estimated delivery dates and the best effort of USG.



## V. CONCLUSIONS AND RECOMMENDATIONS

### A. CONCLUSIONS

U.S. Security Assistance Programs cover a broad range of services which employ funding and the legal authority to provide defense articles and training, economic support, and peacekeeping assistance to key friends and allies.

Turkey embarked upon an intensive program to modernize its armed forces to bring them in line with emerging technologies. The requirement of NATO Foreign Military Sales (FMS) has been, and is still, one of the most important security assistance programs that Turkey uses to modernize and maintain its armed forces.

The purpose of this research has been to document and analyze issues involved with FMS pricing, billing, contract closure and FMS contract administration by the Turkish Navy (TN). Interpretation of the data provided led to the conclusions addressed below.

1. The process of FMS management follows a logical sequence of steps over a prescribed timeline. A letter of request (LOR) initiates the FMS process. A purchaser may request either Price and Availability (P&A) data or a Letter of Offer and Acceptance (LOA). P&A data are usually needed by the foreign government for rough estimates on prices and delivery timeframes. Response times to provide P&A data are 45 days; for LOAs, it is 60 days.

The LOA, also known as an "FMS Case" is a contractual document and provides the purchasing country with required information. The LOA, upon acceptance, is returned to the cognizant military department and to DFAS-DE/I with the required initial payment. DFAS-DE/I then provides obligation authority to the cognizant military department to implement the FMS case.

2. The methodology employed in determining an FMS price depends on whether the price is to be developed before the fact as an estimate on the LOA, or after the fact as the reporting of a cost in the billing system.

The LOA is the primary document used to transit FMS prices to the purchasing country. Elements used in calculating FMS prices may include, but are not limited to, the cost of the item; nonrecurring RDT&E and production costs; contract administration costs; accessorial charges; and administrative charges.

The above charges are combined into two categories: base price and authorized surcharge. Base prices include the cost of the item or service, while the authorized surcharge represents a percentage of the base price, usually a proration of the value of the base price. Authorized surcharges are assessed so that the FMS customers pay a fair share of the overhead and other costs incurred by the USG as a result of providing goods and services.

3. The Arms Export Control Act (AECA), as amended, provides the legal basis for FMS billing policies and procedures. FMS billing provides a mechanism for complying with the requirements of the AECA in that FMS is to be conducted in a "no profit--no loss" manner and that payments are to be made in advance of USG expenditures on the purchaser's behalf.

Implementing agencies report the cost of DoD services, inventory, and new procurement sales to DFAS-DE/I. Based on the data contained in these reports, DFAS-DE/I computes the charges and bills FMS customers for accrued expenditures and those costs resulting from the application of various surcharges.

The basic FMS billing document is the DD Form 645, which is prepared at the end of each calendar quarter. The DD Form 645 serves both as a billing document and a statement of account. Numerous attachments, as applicable, accompany the

DD Form 645, to include the "FMS Delivery Listing," the "FMS Reply Listing to Customer Request for Adjustments," the "FMS Financial Forecast," and the "Holding Account Statement."

4. A case is considered delivered or supply complete when all articles and services contracted for on the LOA have been delivered or performed by the implementing agency. Case closure is then undertaken. A case is considered closed when, in addition to final delivery or performance, all financial transactions, including collections, have been completed and the customer has received a final statement of account for the case.

5. The U.S. FMS policy requires the purchasing country to accept the contract based on estimated prices. The USG uses its best effort to advise the purchaser of identifiable cost increases that might result in an overall increase in estimated costs in excess of ten percent of the total value of the LOA. USG failure to advise of cost increases does not change the purchaser's obligation to pay the USG the total cost.

6. The priority issue for the Turkish Navy (TN) has been the excess case funds due to advance payment based on estimated prices. Since 1991, the amount of excess funds is 4.3 to 16.4 percent of the FMS yearly budget of the Turkish Navy.

7. In some cases, the FMS customer does not have a listing of specific services performed by the U.S. since the information on the LOA is stated in general terms but not in detail.

8. Payments are required 90 days in advance of the time DoD plans deliveries or incurs expenses on behalf of the purchaser. The USG policy also requires the purchaser to pay interest on any net amount by which it is in arrears.

9. FMS customers are not entitled to submit Reports of Discrepancy (ROD) for non-shipment of material when the total

value is less than \$200.00 even though the material is not shipped but billed as shipped.

10. Double Billing cases were at the highest level in 1992 and 1993. The problem is still continuing even though DoD acknowledges the problem.

11. A long standing mutual concern between DoD and FMS customers is the length of time required to close a FMS case after it is supply complete. Many FMS cases on which all material has been delivered are in open status for many years due to a small dollar value of potential contract liability which cannot be determined until all contracted efforts are completed, the final audits are made by DSAA, and the final costs are negotiated. When the final contract price has been determined, which can take five or more years, it is then distributed among all customers of the contract. The FMS case can then be closed. USG implemented accelerated case closure procedures in order to reduce the case closure time.

The average case closure time for the Turkish Navy has decreased from 4.5 years to 2.1 years, after accelerated case closure procedures were implemented in June 1992.

12. Issues encountered by the Turkish agencies when administering a FMS case are mostly due to uncertainties related to administering a contract based on estimated prices, estimated delivery dates and best effort of USG.

## **B. RECOMMENDATIONS**

1. The purchasing country accepts the FMS contract based on estimated prices. The accuracy of estimated prices is key to the purchasing country for planning, funding, and budgeting FMS procurements. The U.S. should develop more accurate estimating methods for FMS customers.
2. The information on the LOA should be stated in detail, not in general terms, by the USG, so that FMS customers have better visibility of actual services performed by the U.S.

3. USG should expedite the transfer of excess funds present in FMS cases to the Turkish Navy holding account, so that the funds can be used for other important programs.
4. FMS customers should be entitled to submit ROD when the material is not shipped but billed as shipped even if total value of the material is less than \$200.00.
5. The Turkish Navy should develop procedures to detect Forced Billing and Double Billing cases as early as possible in order to be entitled to refunds.
6. FMS customers pay the USG 90 days in advance of the time DoD plans deliveries or incurs expenses on behalf of the FMS customer. FMS customers should be entitled to an interest payment on pre-paid funds if the deliveries are not made within 90 days of the payment date.
7. The Turkish Navy (TN) should utilize the Naval Postgraduate School, Acquisition and Contract Management curriculum to assist its FMS managers in overcoming the language barriers and familiarize themselves with the U.S. acquisition and contracting policies, procedures and institutions.

**C. AREAS FOR FURTHER RESEARCH**

1. USG disclaims any liability related to estimated prices and estimated delivery dates for FMS contracts. Can incentives be used in FMS contracts to improve the accuracy of estimated prices and to provide timely deliveries?
2. How should existing U.S. FMS procedures be revised to prevent Forced Billing and Double Billing?



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## APPENDIX. STANDARD TERMS AND CONDITIONS OF THE LOA

### A. UNITED STATES GOVERNMENT (USG) OBLIGATIONS

1. Unless otherwise specified, items will be those which are standard to the U.S. Department of Defense (DoD), without regard to make or model.

2. The USG will furnish the items from its stocks and resources, or will procure them under terms and conditions consistent with DoD regulations and procedures. When procuring for the Purchaser, DoD will, in general employ the same contract clauses, the same contract administration processes, and the same quality and audit inspection procedures as would be used in procuring for itself, except as otherwise requested by the Purchaser and as agreed to by DoD. Unless the Purchaser has requested in writing that a sole source contractor be designated, and the LOA reflects acceptance of such designation by DoD, the Purchaser understands that selection of the contractor source to fill requirements is the responsibility of the USG, which will select the contractor on the same basis used to select contractors for USG requirements. Further, the Purchaser agrees that the U.S. DoD is solely responsible for negotiating the terms and conditions of contracts necessary to fulfill the requirements in the LOA.

3. The USG will use its best efforts to provide the items for the dollar amount and within the availability cited.

4. Under unusual and compelling circumstances, when the national interest of the U.S. requires, the USG reserves the right to cancel or suspend all or part of the LOA at any time prior to the delivery of defense articles or performance of defense services. The USG shall be responsible for termination costs of its suppliers resulting from cancellation or suspension under this section. Termination by the USG of its contracts with its suppliers, other actions pertaining to such contracts, or cessation of deliveries or performance of

defense services is not to be construed as cancellation or suspension of the LOA itself under this section.

5. U.S. personnel performing defense services under the LOA will not perform duties of a combatant nature, including duties relating to training and advising that may engage U.S. personnel in combat activities outside the U.S., in connection with the performance of these defense services.

6. The assignment or employment of U.S. personnel for the performance of the LOA by the USG will not take into account race, religion, national origin, or sex.

7. Unless otherwise specified, each LOA may be made available for public inspection consistent with the national security of the United States.

#### **B. GENERAL PURCHASER AGREEMENTS**

1. The Purchaser may cancel the LOA or delete items at any time prior to delivery of defense articles or performance of defense services. The Purchaser is responsible for all costs resulting from cancellation under this section.

2. The Purchaser agrees, except as may otherwise be mutually agreed in writing, to use the defense articles sold hereunder only:

a. For purposes specified in any Mutual Defense Assistance Agreement between the USG and the Purchaser;

b. For purposes specified in any bilateral or regional defense treaty to which the USG and the Purchaser are both parties, if section B.2.a. is applicable; or,

c. For internal security, individual self-defense, or civic action, if sections B.2.a. and B.2.b. are inapplicable.

3. The Purchaser will not transfer title to, or possession of, the defense articles, components and associated support material, related training or other defense services (including plans, specifications, or information), or technology furnished under the LOA to anyone who is not an

officer, employee, or agent of the Purchaser (excluding transportation agencies), and shall not use or permit their use for purposes other than those authorized, unless the written consent of the USG has first been obtained. The Purchaser will ensure, by all means available, respect for proprietary rights in any items and any plans, specifications, or information furnished, whether patented or not.

The Purchaser also agrees that the defense articles offered will not be transferred to Cyprus or otherwise used to further the severance or division of Cyprus, and recognizes that the U.S. Congress is required to be notified of any substantial evidence that the defense articles sold in the LOA have been used in a manner which is inconsistent with this provision.

4. To the extent that items, including plans, designs, specifications, technical data, or information, furnished in connection with the LOA may be classified by the USG for security purposes, the Purchaser certifies that it will maintain a similar classification and employ measures necessary to preserve such security, equivalent to those employed by the USG and commensurate with security agreements between the USG and the Purchaser. If such security agreements do not exist, the Purchaser certifies that classified items will be provided only to those individuals having an adequate security clearance and a specific need to know in order to carry out the LOA program and that it will promptly and fully inform the USG of any compromise, or possible compromise, of U.S. classified material or information furnished pursuant to the LOA.

The Purchaser further certifies that if a U.S. classified item is to be furnished to its contractor pursuant to the LOA: (a) items will be exchanged through official government channels, (b) the specified contractor has been granted a facility security clearance by the Purchaser at a level at least equal to the classification level of the U.S. information involved, (c) all contractor personnel requiring

access to such items have been cleared to the appropriate level by the Purchaser, and (d) the Purchaser will assume responsibility for administering security measures while in the contractor's possession. If a commercial transportation agent is to be used for shipment, the Purchaser certifies that such agent has been cleared at the appropriate level for handling classified items. These measures will be maintained throughout the period during which the USG may maintain such classification. The USG will use its best efforts to notify the Purchaser if the classification is changed.

### **C. INDEMNIFICATION AND ASSUMPTION OF RISKS**

1. The Purchaser recognizes that the USG will procure and furnish the items described in the LOA on a non-profit basis for the benefit of the Purchaser. The Purchaser therefore undertakes to indemnify and hold the USG, its agents, officers, and employees harmless from any and all loss or liability (whether in tort or in contract) which might rise in connection with the LOA because of:

a. Injury to or death of personnel of Purchaser or third parties, or

b. Damage to or destruction of (a) property of DoD furnished to Purchaser or suppliers specifically to implement the LOA, (b) property of Purchaser (including the items ordered by Purchaser pursuant to the LOA, before or after passage of title to Purchaser), or

c. Property of third parties, or

d. Infringement or other violations of intellectual property or technical data rights.

2. Subject to express, special contractual warranties obtained for the Purchaser, the Purchaser agrees to relieve the contractors and subcontractors of the USG from liability for, and will assume the risk of, loss or damage to:

a. Purchaser's property (including items procured pursuant to the LOA, before or after passage of title to Purchaser), and

b. Property of DoD furnished to suppliers to implement the LOA, to the same extent that the USG would assume for its property if it were procuring for itself the items being procured.

#### **D. FINANCIAL TERMS AND CONDITIONS**

1. The prices of items to be procured will be billed at their total cost to the USG. Unless otherwise specified, the cost of items to be procured, availability determination, payment schedule, and delivery projections quoted are estimates based on the best available data. The USG will use its best efforts to advise the Purchaser or its authorized representatives of:

a. Identifiable cost increases that might result in an overall increase in the estimated costs in excess of ten percent of the total value of the LOA,

b. Changes in the payment schedule, and

c. Delays which might significantly affect estimated delivery dates. USG failure to advise of the above will not change the Purchaser's obligation under all subsections of section D.4.

2. The USG will refund any payments received for the LOA which prove to be in excess of the final total cost of delivery and performance and which are not required to cover arrearages on other LOAs of the Purchaser.

3. Purchaser failure to make timely payments in the amounts due may result in delays in contract performance by DoD contractors, claims by contractors for increased costs, claims by contractors for termination liability for breach of contract, claims by USG or DoD contractors for storage costs, or termination of contracts by the USG under this or other

open Letters of Offer and Acceptance of the Purchaser at the Purchaser's expense.

4. The Purchaser agrees:

a. To pay to the USG the total cost to the USG of the items even if costs exceed the amounts estimated in the LOA.

b. To make payment(s) by check or wire transfer payable in U.S. dollars to the Treasurer of the United States.

c. If Terms of Sale specify "Cash with acceptance," to forward with the LOA a check or wire transfer in the full amount shown as the estimated Total cost, and agrees to make additional payment(s) upon notification of cost increase(s) and request(s) for funds to cover such increase(s).

d. If Terms of Sale specify payment to be "Cash prior to delivery," to pay to the USG such amounts at such times as may be specified by the USG (including initial deposit) in order to meet payment requirements for items to be furnished from the resources of DoD. USG requests for funds may be based on estimated costs to cover forecasted deliveries of items. Payments are required 90 days in advance of the time DoD plans such deliveries or incurs such expenses on behalf of the Purchaser.

e. If Terms of Sale specify payment by "Dependable undertaking," to pay to the USG such amounts at such times as may be specified by the USG (including initial deposit) in order to meet payments required by contracts under which items are being procured, and any damages and costs that may accrue from termination of contracts by the USG because of Purchaser's cancellation of the LOA. USG requests for funds may be based upon estimated requirements for advance and progress payments to suppliers, estimated termination liability, delivery forecasts, or evidence of constructive delivery, as the case may be. Payments are required 90 days

in advance of the time USG makes payments on behalf of the Purchaser.

f. If Terms of Sale specify "Payment on delivery," that bills may be dated as of the date(s) of delivery of the items, or upon forecasts of the date(s) thereof.

g. That requests for funds or billings are due and payable in full on presentation or, if a payment date is specified in the request for funds or bill, on the payment date so specified, even such payment date is not in accord with the estimated payment schedule, if any, contained in the LOA. Without affecting Purchaser's obligation to make such payment(s) when due, documentation concerning advance and progress payments, estimated termination liability, or evidence of constructive delivery or shipment in support of requests for funds or bills will be made available to the Purchaser by DoD upon request. When appropriate, the Purchaser may request adjustment of any questioned billed items by subsequent submission of discrepancy reports, Standard Form 364.

h. To pay interest on any net amount by which it is in arrears on payments, determined by considering collectively all of the Purchaser's open LOAs with DoD. Interest will be calculated on a daily basis. The principal amount of the arrearage will be computed as the excess of cumulative financial requirements of the Purchaser over total cumulative payments after quarterly billing payment due dates. The rate of interest paid will be a rate not less than a rate determined by the Secretary of the Treasury taking into consideration the current average market yield on outstanding short-term obligations of the USG as of the last day of the month preceding the net arrearage and shall be computed from the date of net arrearage.

i. To designate the Procuring Agency and responsible Paying Office and address thereof to which the USG will submit requests for funds and bills under the LOA.

#### **E. TRANSPORTATION AND DISCREPANCY PROVISIONS**

1. The USG agrees to deliver and pass title to the Purchaser at the initial point of shipment unless otherwise specified in the LOA. With respect to items procured for sale to the Purchaser, this will normally be at the manufacturer's loading facility; with respect to items furnished from USG stocks, this will normally be at the U.S. depot. Articles will be packed, crated, or otherwise prepared for shipment prior to the time title passes. If "Point of Delivery" is specified other than the initial point of shipment, the supplying U.S. Department or Agency will arrange movement of the articles to the authorized delivery point as a reimbursable service but will pass title at the initial point of shipment. The USG disclaims any liability for damage or loss to the items incurred after passage of title irrespective of whether transportation is by common carrier or by the U.S. Defense Transportation System.

2. The Purchaser agrees to furnish shipping instructions which include Mark For and Freight Forwarder Codes based on the Offer/Release Code.

3. The Purchaser is responsible for obtaining insurance coverage and customs clearances. Except for articles exported by the USG, the Purchaser is responsible for ensuring that export licenses are obtained prior to export of U.S. defense articles. The USG incurs no liability if export licenses are not granted or they are withdrawn before items are exported.

4. The Purchaser agrees to accept DoD Forms 645 or other delivery documents as evidence that title has passed and items have been delivered. Title to defense articles transported by parcel post passes to the Purchaser at the time of parcel post shipment. Standard Form 364 will be used in submitting claims to the USG for overage, shortage, damage, duplicate billing, item deficiency, improper identification, improper documentation, or non-shipment of defense articles and non-performance of defense services and will be submitted

promptly by the Purchaser. DoD will not accept claims related to items of \$200 or less for overages, shortages, damages, non-shipment, or non-performance. Any claim, including a claim for shortage (but excluding a claim for non-shipment/receipt of an entire lot), received after one year from passage of title to the article or from scheduled performance of the service will be disallowed by the USG unless the USG determines that unusual and compelling circumstances involving latent defects justify consideration of the claim. Claims, received after one year from the date of passage of title or initial billing, whichever is later, for non-shipment/non-receipt of an entire lot will be disallowed by the USG. The Purchaser agrees to return discrepant articles to USG custody within 180 days from the date of USG approval of such return.

#### **F. WARRANTIES**

1. The USG does not warrant or guarantee any of the items sold pursuant to the LOA except as provided in section F.1.a. DoD contracts include warranty clauses only on an exception basis. If requested by the Purchaser, the USG will, with respect to items being procured, and upon timely notice, attempt to obtain contract provisions to provide the requested warranties. The USG further agrees to exercise, upon the Purchaser's request, rights (including those arising under any warranties) the USG may have under contracts connected with the procurement of these items. Additional costs resulting from obtaining special contract provisions or warranties, or the exercise of rights under such provisions or warranties, will be charged to the Purchaser.

a. The USG warrants the title of items sold to the Purchaser hereunder but makes no other warranties. In particular the USG disclaims liability resulting from infringement or other violation of intellectual property or technical data rights occasioned by the use or manufacture outside the U.S. by or for the Purchaser.

b. The USG agrees to exercise warranties on behalf of the Purchaser to assure, to the extent provided by the warranty, replacement or correction of such items found to be defective, when such material is procured for the Purchaser.

2. Unless the condition of defense articles is identified to be other than serviceable (for example, "As is"), DoD will repair or replace at no extra cost defense articles supplied from DoD stocks which are damaged or found to be defective in respect to material or workmanship when it is established that these deficiencies existed prior to passage of title, or found to be defective in design to such a degree that the items cannot be used for the purpose for which they were designed. Qualified representatives of the USG and of the Purchaser will agree on the liability hereunder and the corrective steps to be taken.

**G. DISPUTE RESOLUTION**

1. The LOA is subject to U.S. Federal procurement law.

2. The USG and the Purchaser agree to resolve any disagreement regarding the LOA by consultations between the USG and the Purchaser and not to refer any such disagreement to any international tribunal or third party for settlement.

[Ref. 3:pp. 177-180]

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